

# **RESALE PRICE MAINTENANCE AFTER *LEEGIN*: THE CURIOUS CASE OF CONTACT LENSES**

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**Abstract**

*Resale price maintenance (RPM) is a controversial pricing practice for managing retail distribution channels. In Leegin Creative Leather Products, Inc. v. PSKS, Inc. (2007), the Supreme Court abolished a nearly century-old per se rule against RPM established in Dr. Miles Medicine Co. v. John D. Park & Sons (1911). Henceforth, RPM will be judged under federal antitrust law by the rule of reason – a less restrictive standard that requires courts to weigh all the relevant circumstances of a case to assess whether a practice unreasonably restrains trade. Despite that the decision in Leegin leaves many unanswered questions, the decision has prompted an increasing number of consumer goods manufacturers to adopt RPM in the management of their retailer relationships. Recently, the widespread use of restrictive pricing practices in the retail distribution of contact lenses have drawn attention and elevated debate over the practice. Pending lawsuits in the industry have been identified as an important “test case” for antitrust’s new vertical pricing regime following Leegin. Drawing upon relevant literatures from law, economics, and business, together with publically available information, important questions in the debate and related cases that share significance for scholarship and practice are elaborated upon and examined. This examination reveals insights helpful to understanding the antitrust implications of contact lens manufacturers’ pricing practices and for advancing academic knowledge, marketing practice, and competition policy involving RPM.*

**Key words:** price, distribution, distribution restraints, vertical price fixing, resale price maintenance, *Leegin*, contact lens

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## INTRODUCTION

Minimum resale price maintenance (RPM) is a controversial pricing practice for managing retail distribution channels. RPM (also known as *vertical price fixing*) involves an agreement between independent firms at different levels of a distribution channel that limits the resale price below which sales of a product are not permitted.<sup>1</sup> Given its use “permits a manufacturer to limit the normal pricing behavior of its resellers,” considerable public policy debate surrounds the practice of RPM.<sup>2</sup>

### Background

A 2007 decision of the U.S. Supreme Court has prompted an increasing number of consumer goods manufacturers to adopt RPM in the management of their retailer relationships. As summarized in Table 1, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*<sup>3</sup> abolished a nearly century-old *per se* rule against RPM originally established in *Dr. Miles Medicine Co. v. John D. Park & Sons*.<sup>4</sup> The prior rule had become the target of increasing skepticism among scholars, policymakers, and judges. Scholarship had also increasingly theorized RPM’s beneficial effects, and state and federal legislative exceptions and decisions of the Supreme Court had increasingly permitted RPM under particular circumstances. Following *Leegin*, RPM will be judged under federal antitrust law applying the *rule of reason* – a less restrictive standard that requires courts to weigh all the relevant circumstances of a case to assess whether a practice unreasonably restrains trade.

### Resale Price Maintenance and Contact Lenses

Widespread adoption of restrictive pricing practices in the contact lens industry has recently garnered attention and elevated debate over the practice of RPM. Responding to complaints of price hikes as high as 198% on popular brands of contact lenses, a subcommittee of the U.S. Senate Committee on the Judiciary held hearings in 2014 on the pricing practices and competition occurring in the contact lens industry.<sup>5</sup> Following that hearing and subsequent to concerns raised by nonprofit groups including Consumers Union<sup>6</sup> and the American Antitrust Institute (AAI),<sup>7</sup> over 50 lawsuits asserting antitrust claims under federal and state laws were filed on behalf of aggrieved consumers against the four major contact lens manufacturers.<sup>8</sup> In

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<sup>1</sup> Mary Jane Sheffet & Debra L. Scammon, *Resale Price Maintenance: Is It Safe to Suggest Retail Prices?*, 49 JOURNAL OF MARKETING 82 (1985).

<sup>2</sup> ANNE T. COUGHLAN, ERIN ANDERSON, LOUIS W. STERN & ADEL I. EL-ANSARY, MARKETING CHANNELS 285 (2001).

<sup>3</sup> *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* 551 U.S. 877 (2007).

<sup>4</sup> *Dr. Miles Medicine Co. v. John D. Park & Sons* 220 U.S. 373 (1911).

<sup>5</sup> Jonathan Randles, *Contact Lens Cos. Face Collusion Suit from Indirect Buyers*, LAW360.COM (2015), <http://www.law360.com/competition/articles/628984> (last visited 3/10/2015).

<sup>6</sup> Consumerreports.org, *Contact-Lens Pricing-Policy Shift Is a Bad Prescription for Consumers*, CONSUMER REPORTS POLICY & ACTION (2014), <http://www.consumerreports.org/cro/news/2014/08/contact-lens-pricing-policy-shift-is-a-bad-prescription-for-consumers/index.htm>.

<sup>7</sup> Albert Foer, American Antitrust Institute & Sandeep Vaheesan, Special Counsel American Antitrust Institute, *Re: Action Needed to Address Resale Price Maintenance in Contact Lenses—and Countless Other Markets* (2014), <http://www.antitrustinstitute.org/sites/default/files/AAI%20Letter%20on%20RPM%20in%20Contact%20Lenses.pdf>.

<sup>8</sup> Ed Silverstein, *Another Lawsuit Filed in Response to Alleged Contact Lens Price Conspiracy*, INSIDE COUNSEL (March 12, 2015), <http://www.insidecounsel.com/2015/03/12/another-lawsuit-filed-in-response-to-alleged-conta>

addition, Costco Wholesale filed its own antitrust lawsuit against one of the manufacturers as an affected reseller. Simultaneously, various states began to consider the adoption of laws that would prohibit restrictive pricing practices in the sale of contact lenses.<sup>9</sup> Utah became the first to pass such a law in 2015, but that law has since become the subject of a constitutional challenge by contact lens manufacturers.<sup>10</sup> Although reports suggest that the Federal Trade Commission (FTC) and States Attorneys General are investigating pricing practices in the contact lens industry,<sup>11</sup> curiously both have yet to offer public comment or engage in public actions based on their reported investigations.<sup>12</sup>

### Questions for Scholarship and Practice

The public and private debate involving the restrictive pricing practices of contact lens manufacturers poses important implications for competition policy and antitrust law. According to one commentator, “For players in many consumer goods sectors, the contact lens wars may be a test case for the new vertical pricing regime in antitrust, and the stakes are higher than some imagined.”<sup>13</sup> The rule of reason requires that a factfinder weigh all the circumstances of a case including “specific information about the relevant business and a restraint’s history, nature and effect.”<sup>14</sup> However, “...empirical evidence on the topic [of RPM] is limited,”<sup>15</sup> there has been “little case law developing the rule of reason standard for RPM,”<sup>16</sup> and the Court’s decision in “*Leegin* leaves many questions unanswered.”<sup>17</sup> In that “lower courts are going to have difficulty fashioning a rule of reason for resale price maintenance,”<sup>18</sup> these circumstances “create enormous confusion and misunderstanding in the business community.”<sup>19</sup>

Recognizing the implications of their decision and the economic dangers of RPM, in *Leegin*, the Supreme Court admonished that “courts would have to be diligent in eliminating

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<sup>9</sup> Visionmonday.com, *What’s the Status of State Bills Opposing UPP Policies?* (2015), <http://www.visionmonday.com/technology/contact-lenses/article/whats-the-status-of-state-bills-opposing-upp-policies/#sthash.SmWFTtRT.dpuf>.

<sup>10</sup> Tom Harvey, The Salt Lake Tribune, *Contact Lens Makers Suing Utah Attorney General to Stop Enforcement of New Law*, THE SALT LAKE TRIBUNE (2015), <http://www.sltrib.com/news/2400816-155/contact-lens-makers-suing-utah-attorney>.

<sup>11</sup> Katie Thomas, *Contact Lens Makers and Discounters Tussle Over Price Setting*, NYTIMES.COM (2015), [http://www.nytimes.com/2015/03/27/business/contact-lens-makers-and-discounters-tussle-over-price-setting.html?\\_r=0](http://www.nytimes.com/2015/03/27/business/contact-lens-makers-and-discounters-tussle-over-price-setting.html?_r=0).

<sup>12</sup> Phillip E. Areeda & Herbert J. Hovenkamp, ANTITRUST LAW (Index and Tables Pamphlet 2008 edition) A-29 (2009) (Observing that “Absent assistance from the Antitrust Division or the FTC, many instances of anticompetitive RPM may go unchallenged.”).

<sup>13</sup> August T. Horvath, *Utah — The Latest Battleground In Resale Price Maintenance*, LAW360.COM (2015), <http://www.law360.com/articles/670137/utah-the-latest-battleground-in-resale-price-maintenance>.

<sup>14</sup> *Leegin* (2007), 629.

<sup>15</sup> *Leegin* (2007), 639.

<sup>16</sup> Horvath (2015).

<sup>17</sup> Christine A. Varney, Assistant Attorney General Antitrust Division U.S. Department of Justice, *Antitrust Federalism: Enhancing Federal/State Cooperation*, U.S. Department of Justice, 9 (2009), <http://www.justice.gov/atr/public/speeches/250635.htm>.

<sup>18</sup> Areeda & Hovenkamp (2009), A-27. Areeda & Hovenkamp (2009), A-28 (noting that “The majority gave little guidance as to how rule of reason challenges to RPM should proceed.”).

<sup>19</sup> William Joseph Baer, United States Department of Justice Antitrust Division, Nomination of William Joseph Baer, of Maryland, Nominee to Be Assistant Attorney General, Antitrust Division, U.S. Department of Justice: Hearing Before the Committee On the Judiciary, United States Senate, One Hundred Twelfth Congress, Second Session, July 26, 2012, Serial No. J-112-91 (July 26, 2012).



their [RPM's] anticompetitive effects”<sup>20</sup> and counseled that “[a]s courts gain experience considering the effects of these restraints ..., they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses.”<sup>21</sup> Thus, several questions in the current lawsuits and the broader debate share significance for future scholarship and practice involving RPM in both law and business.

**What influence will the nature of distribution have?** The rule of reason requires that specific information about a business be considered when assessing the antitrust implications of a distribution restraint. Those complaining of pricing practices in the contact lens industry point out that features of the retail distribution and purchase of contact lenses are different from other products. This includes that consumers who purchase contact lens must buy the brand of contact lens their ECPs prescribe for them, that their ECPs can both prescribe and sell contact lenses, and that consumers lack the specialized knowledge to know if the brand of contact lenses prescribed and sold to them is best for them. These features of distribution are contended to distort competition in the sale of contact lenses in ways that are exacerbated by the restrictive pricing practices of contact lens manufacturers. Antitrust goals focus on the competitive process and the benefits that result for consumers. Consequently, important questions in the current debate concern the influence these features and their effects will have in the assessment of contact lens manufacturers’ pricing practices.

**What impact will prior channel history make?** The rule of reason also requires that a restraint’s history be considered when assessing the antitrust implications of a distribution restraint. The contact lens industry has a long history of conflict between traditional resellers (i.e., eye care professionals) (ECPs) and new forms of retail distribution for contact lenses (e.g., pharmacies, mail order, mass merchandisers, wholesale clubs, Internet retailers, etc.). A reoccurring theme in these past conflicts is that because of the unique role played by ECPs in the retail distribution of contact lenses, manufacturers have sought to appease ECPs through restraining the competitive pressures exerted by alternative lower price channels of retail distribution. Considerable public and private actions document this conflict. This same theme is now at the heart of the current dispute involving the restrictive pricing practices of contact lens manufacturers. Restrictive pricing practices involving RPM are known to undermine the benefits of retail innovation brought about through more efficient (i.e., less costly) forms of distribution. Innovation that benefits consumers through lower prices and other means is an important goal for antitrust. Accordingly, significant questions in the current debate concern the impact that past channel conflicts over innovation will make in the assessment of contact lens manufacturers’ restrictive pricing practices.

**What standard of agreement will be applied?** Under the rule of reason a further important consideration involves the nature of the restraint. Contact lens manufacturers describe their pricing practices as involving a “unilateral” price policy (UPP). However, complainants argue that manufacturers have entered into agreements with their resellers to abide by these pricing practices. Evidence of a vertical agreement was required pre-*Leegin* under the *per se* rule and according to the dissent in *Leegin*, this remains good law. Nevertheless, antitrust scholars contend that given the rule of reason’s emphasis of competitive effects, such a strict standard of

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<sup>20</sup> Leegin (2007), 897.

<sup>21</sup> Leegin (2007), 630.

agreement may not be necessary, or even desirable. Recent trends in distribution management toward closer relationships between manufacturers and retailers likely also make it increasingly difficult for manufacturers to credibly assert UPP arrangements to avoid antitrust scrutiny. Consequently, important questions concern the standard of agreement that will be applied to the restrictive pricing practices of contact lens manufacturers.

**What competitive harms will be identified?** Should the restrictive pricing practices of contact lens manufacturers be found to meet the requisite standard of agreement, an important consideration under the rule of reason concerns any harms to competition that result from the practice. Depending on the rule of reason approach applied, plaintiffs may be required to offer proof that the use of RPM has harmful tendencies or harmful effects for competition. Antitrust scholars and the Supreme Court have identified different factors relevant to inquiries of RPM's harmful tendencies and the most historically relevant explanation for RPM's harmful effects is that RPM results in higher retail prices through forestalling cost lowering innovations in distribution (i.e., the *forestalling innovation thesis*). Consequently, important questions in the current debate concern these factors and the applicability of this explanation to the restrictive pricing practices of contact lens manufacturers.

**What competitive benefits will be found?** Should the pricing practices of contact lens manufacturers be found to pose adverse tendencies or effects for competition, an important further consideration under the rule of reason concerns any benefits the practices pose for competition. The most historically relevant explanation of RPM's competitive benefits is the *free rider thesis*. This explanation describes how RPM encourages retailers to promote a manufacturer's product by discouraging consumers from shopping at one retailer and then purchasing the product from another retailer. A related and more recent economic explanation, the *incentive incompatibility thesis*, describes how RPM encourages retail promotion in the absence of free riding. Other explanations of RPM's benefits have also been advanced over time (e.g., *loss-leader thesis*). Given the historical relevance of the free rider thesis and the contemporary popularity of the incentive incompatibility thesis, important questions in the current debate concern the extent to which these theories apply and whether they offer a legitimate business justification for the restrictive pricing practices of contact lens manufacturers.

**What role will less restrictive alternatives take?** Following the rule of reason, legitimate business justifications (i.e., competitive benefits) for a distribution restraint may be rebutted where competitively less restrictive alternatives are reasonably available. Thus, an important final consideration concerning contact lens manufacturers' pricing practices involves the nature and availability of business alternatives for achieving manufacturers' goals in restricting resale prices. Past research reveals that over time more and more manufacturers have adopted strategies for encouraging retail promotion of their products that, when compared to RPM, are less restrictive of competition and that offer greater accountability for retailers' promotional activities. In addition, recent trends indicate that rather than strategies like RPM that are designed to discourage consumers from shopping at one retailer and then purchasing from another, a growing number of manufacturers are adopting a different mindset and employing strategies that embrace and profit from their customers' cross-channel (i.e., free riding) shopping behavior. As a consequence, these alternatives and the trends that accompany them raise

important questions for the current debate over the restrictive pricing practices of contact lens manufacturers and for the future of RPM as a channel pricing practice.

## Overview and Highlights

In the sections that follow, the aforementioned questions are elaborated upon in more depth and then examined drawing on relevant literatures from law, economics, and business together with available information about the contact lens industry. This multidisciplinary effort reveals several insights:

- *First*, various features of the retail distribution and consumer purchase of contact lens distort interbrand and intrabrand competition in ways that are exacerbated by the restrictive pricing practices of contact lens manufacturers.
- *Second*, the long history of inter-channel conflict in the contact lens industry offers important context for understanding the antitrust implications of contact lens manufacturers' pricing practices.
- *Third*, as a result of the Supreme Court's ruling in *Leegin* and relevant trends in distribution management, there are significant questions as to whether the pricing practices of contact lens manufacturers will be found to be unilateral, as claimed, or whether they will be found to involve an agreement and therefore RPM.
- *Fourth*, the contact lens industry and the distribution of contact lens possess features that are consistent with factors relevant for understanding RPM's harmful tendencies and with the most historically relevant explanation of RPM's harmful effects (i.e., the forestalling retail innovation thesis).
- *Fifth*, the contact lens industry and the distribution of contact lens possess features that are inconsistent with the most historically relevant explanation (i.e., the free rider thesis), a popular more recent explanation (i.e., the incentive incompatibility thesis), and other relevant theories of RPM's beneficial effects.
- *Sixth* and last, existing literature, prior analyses, and recent trends in distribution management suggest that there may be competitively less restrictive alternatives to the pricing practices of contact lens manufacturers for inducing retail promotion of their products.

Analyses in the current debate that bear in mind these insights should be helpful to both public and private assessments of the competitive implications of contact lens manufacturers' pricing practices. These insights should also be helpful to advancing knowledge and practice of RPM following *Leegin*.

## CONTACT LENSES INDUSTRY

### Contact Lenses

Contact lenses are a medical device consisting of a thin lens placed on the surface of the eye. Contacts (as they are also called) are worn by individuals to improve their vision, for therapeutic reasons, or for cosmetic purposes. Data indicate that as of June 2014, there were 39.3 million contact lens wearers in the United States (U.S.).<sup>22</sup> Depending on the materials used,

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<sup>22</sup> The Vision Council Research, *VisionWatch Eyewear U.S. Study, June 2014, Contact Lenses, Users (adult wearers)*, 24 (2014) ("Currently wear contacts at all").

contacts include soft, rigid and hybrid lens.<sup>23</sup> Contact lenses may also vary depending on their wear schedule (e.g., daily wear, extended wear) and replacement period (e.g., daily, weekly or monthly basis).<sup>24</sup> The most popular contacts are soft contact lenses.<sup>25</sup>

## Market Overview

As of 2014, total retail sale sales of contact lenses in the U.S. are estimated to be nearly \$4.9 billion.<sup>26</sup> Four companies currently dominate the sale of contact lenses in the U.S., together possessing nearly 99% of the market: this includes Johnson and Johnson (J&J) who, based on estimates, led the market in 2013 with 43.2% of sales, followed by Ciba Vision (Ciba) with 22.7%, Cooper Vision with 22.1%, and Bausch & Lomb (B&L) with 10.5% of U.S. sales.<sup>27</sup>

## Retail Distribution

**Distribution process.** The distribution (i.e., prescribing) process for contact lenses follows several steps. Eye care professionals (i.e., ECPs) control the prescribing process.<sup>28</sup> This process includes (1) an *examination* to determine eye health, lens power, and contact lens curvature and diameter<sup>29</sup> and (2) a *fitting* “that begins after the initial eye examination and ends when a successful fit has been achieved or, in the case of a renewal prescription, ends when the prescriber determines that no change in prescription is required.”<sup>30</sup> ECPs charge fees for these examinations and charge fees for fitting their patients with the appropriate contact lens. Contact lens prescriptions require certain information<sup>31</sup> and specify a particular brand of contact lens.<sup>32</sup>

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<sup>23</sup> Federal Trade Commission, *The Strength of Competition in the Sale of Rx Contact Lenses: An FTC Study*, 6 (2005).

<sup>24</sup> FTC (2005), 7.

<sup>25</sup> FTC (2005), 6.

<sup>26</sup> Euromonitor International, *Contact Lenses in the U.S.*, 4 (2014).

<sup>27</sup> Euromonitor International (2014), 5.

<sup>28</sup> FTC (2005), 6.

<sup>29</sup> FTC (2005), footnote 16.

<sup>30</sup> Fairness to Contact Lens Consumers Act, 15 USC 7601 (2004) (The term “contact lens fitting” may include “(A) an examination to determine lens specifications; (B) except in the case of a renewal of a prescription an initial evaluation of the fit of the lens on the eye; and (C) medically necessary follow up examinations.”)

<sup>31</sup> FCLCA (2004), 7610 (“The term “contact lens prescription” means a prescription, issued in accordance with State and Federal law, that contains sufficient information for the complete and accurate filling of a prescription, including the following: (A) Name of the patient. (B) Date of examination. (C) Issue date and expiration date of prescription. (D) Name, postal address, telephone number, and fac-simile telephone number of prescriber. (E) Power, material or manufacturer or both. (F) Base curve or appropriate designation. (G) Diameter, when appropriate. (H) In the case of a private label contact lens, name of manufacturer, trade name of private label brand, and, if applicable, trade name of equivalent brand name.”).

<sup>32</sup> Dr. Millicent Knight, Johnson & Johnson, *Letter to Optometrists* (undated) (“Contact lens fitting is complex and each prescription must include brand information to be complete and to assure patient safety.”). Katie Thomas, *The New York Times*, *Interview of Brian Bethers*, 1800-Contacts, 3 (undated) (“The other difference in this industry from many, many other medical devices is that the actual brand that you can wear is on the prescription that you receive from your provider. So that means that you receive a specific brand in your prescription.”). Jay MaGure, 1-800 Contacts, *Illinois House Bill 2450 Hearing*, 16 (2015) (Describing that prescriptions are by brand: “They are 100 percent by brand. That’s federal law.”). Dr. Brian Plattner, Optometrist, *Illinois House Bill 2450 Hearing*, 17 (2015) (Responding to the question so when you write a prescription, you write the prescription by brand: “That’s correct.”). Rod Monroe, Oregon State Senate District 24, Oregon Senate Committee On Judiciary, *Senate Bill 933 Hearing*, 2 (2015) (“Contacts can’t be purchased without a prescription, which includes the exact brand and model

Those that sell contact lenses may sell them only in accordance with a contact lens prescription.<sup>33</sup> A prescription is valid for 1 year.<sup>34</sup>

To fill their prescription, should their ECP sell contact lenses, patients may obtain the contact lenses prescribed for them from their prescribing ECP. However, as determined by the FTC, “the evolution of contact lens technology now allows the sale of the lenses to be unbundled from the fitting exam.”<sup>35</sup> Consequently, according to the Consumer Union, “In short, there’s no reason for the provision of professional eye care services to be tied to the sale of contact lenses.”<sup>36</sup> The Fairness to Contact Lens Consumers Act (FCLCA),<sup>37</sup> enacted in 2004, was promulgated to provide “consumers with a greater ability to fill their prescriptions from sellers other than their prescribing eye care practitioner” and thereby “enhance competition in the market for contact lenses.”<sup>38</sup> As codified, the FCLCA expressly prohibits ECPs from requiring that patients purchase their contact lenses from the ECP that prescribes them.<sup>39</sup>

**Channels of distribution.** Pursuant to the FCLCA, consumers may consider alternatives other than their prescribing ECP when purchasing contact lenses. Thus, to reach consumers, manufacturers distribute their contact lenses through various channels of retail distribution. Depending on the channel, manufacturers may, or may not, utilize intermediaries. According to their website, the largest U.S. intermediary distributor of soft contact lenses is ABB Concise Optical Group who supplies more than two-thirds of the ECPs in the U.S.<sup>40</sup>

Channels of retail distribution for contact lenses may be grouped into different categories by their professional credentials, commercial focus, and model of selling.<sup>41</sup> According to the FTC, the two principal groups are *independent* and *commercial sellers*, although reportedly there is significant variation within each.<sup>42</sup> As described by the FTC:

- **Independent ECPs.** These retailers are optometrists or ophthalmologists who both prescribe and sell optical products. Most are single entities, although some have more than one outlet.<sup>43</sup>
- **Commercial operations.** These retailers include local and national optical chains (e.g., LensCrafters, Pearle), mass merchandisers (e.g., Target, Wal-Mart), and wholesale clubs (e.g., Sam's, Costco, BJ's). These firms sell optical goods, and many have affiliated ECPs who conduct examinations and prescribe contact lenses, although the share of their

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you must buy, and cannot be substituted. No generic. Once prescribed, a patient cannot switch brands without paying for another fitting. This means that increased costs are paid entirely by the patient.”)

<sup>33</sup> Federal Trade Commission, *Possible Anticompetitive Barriers to E-Commerce: Contact Lenses*, 28 (2004) (“Most contact lens prescriptions, unlike eyeglass prescriptions, specify a particular brand of lens. Some states require this and prohibit a dispenser from substituting a different brand.”).

<sup>34</sup> Euromonitor International (2014), 14.

<sup>35</sup> FTC (2005), 5.

<sup>36</sup> George Slover, Consumers Union, *Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?*, U.S. Senate, Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights, (2014).

<sup>37</sup> FCLCA (2004).

<sup>38</sup> FTC (2005), 1.

<sup>39</sup> FCLCA (2004) (“A prescriber may not— (1) require purchase of contact lenses from the prescriber or from another person as a condition of providing a copy of a prescription under subsection (a)(1) or (a)(2) or verification of a prescription under subsection (a)(2).”). FTC (2005), 1.

<sup>40</sup> Abbconceive.com, *ABB Optical Group About Us* (2015), [https://www.abbconceive.com/About\\_Us.aspx](https://www.abbconceive.com/About_Us.aspx).

<sup>41</sup> FTC (2005), 8-9.

<sup>42</sup> FTC (2005), 8-9.

<sup>43</sup> FTC (2005), 8-9.



optical revenues from examinations tends to be less than the share registered by the independents.<sup>44</sup>

- **Online and mail order retailers.** These retailers (e.g., 1-800 Contacts, Vision Direct) comprise a unique segment of commercial retail sellers. They do not perform examinations, but concentrate primarily on the sale of replacement contact lenses.<sup>45</sup>

**Trends in distribution.** Various trends characterize the retail distribution of contact lenses. In 2003, independent ECPs operated the largest number of outlets (22,500 retail locations), and accounted for the largest share of distribution (68.4%) in the sale of contact lenses.<sup>46</sup> Independent ECPs were followed in number and share of contact lens sales by major chains (8,700 retail locations), other smaller chains (3,500 retail locations), mass merchandisers (1,800 retail locations), ware house clubs (1,200 retail locations), and HMOs (700 retail locations).<sup>47</sup> At the time, ECPs distributed the greatest share of contact lenses with Internet/mail order sellers distributed a smaller share; and optical chains, mass merchandisers, and other retailers ranked somewhere in between.<sup>48</sup> However, analyses conducted by the FTC in 2004 concluded that “[n]on-traditional contact lens sellers, such as Internet and mail order providers, represent a unique alternative distribution channel and offer some consumers a combination of price and convenience that they value highly.”<sup>49</sup> Further, as found by the FTC “consumers can often achieve significant savings by purchasing replacement lenses from sellers other than their eye care providers...”<sup>50</sup> More recent analyses find that as of 2014, store based retailing of contact lenses amounts to 81.8% of retail sales (down from 85.5% in 2009) and non-store retailing has increased to 18.2% (up from 14.5% in 2009) of sales.<sup>51</sup> Internet retailing of contact lens has grown to capture 14.9% of sales in 2014<sup>52</sup> and is forecasted to grow and account for 18% of sales by 2019.<sup>53</sup> Assessing this trend, industry observers report that despite “...stores that offer services from both optometrists and opticians have a competitive advantage for offering convenience and professionalism, and thus remain the preferred route of purchase for many consumers,”<sup>54</sup> but “Internet retailers have gained a competitive advantage over more traditional retail channels by promising cheaper prices and offering free shipping and convenient restocking.”<sup>55</sup> These observers conclude that “E-commerce channels have been successful in this field because they are able to offer convenience and have successfully marketed themselves as being the most affordable.”<sup>56</sup>

**Interfirm arrangements.** Limited current public data describes the nature of interfirm arrangements between contact lens manufacturers and their resellers. However, in the past, these arrangements have included the use of private label brands and limited distribution. Private label

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<sup>44</sup> FTC (2005), 8-9.

<sup>45</sup> FTC (2005), 8-9.

<sup>46</sup> FTC (2005), 9.

<sup>47</sup> FTC (2005), 9.

<sup>48</sup> FTC (2005), 12-13.

<sup>49</sup> FTC (2004), 12.

<sup>50</sup> FTC (2004), 13.

<sup>51</sup> Euromonitor International (2014), 6.

<sup>52</sup> Euromonitor International (2014), 6.

<sup>53</sup> Euromonitor International (2014), 16.

<sup>54</sup> Euromonitor International (2014), 14.

<sup>55</sup> Euromonitor International (2014), 15.

<sup>56</sup> Euromonitor International (2014), 1.

brands involved arrangements where a retail seller sells a national name brand under a different name including a name unique to that seller (e.g., Wal-Mart, Pearle Vision, Target, Lens Crafters).<sup>57</sup> Limited distribution arrangements involved manufacturers that limited the retail distribution of their lenses to retail outlets that offered some form of eye care service.<sup>58</sup> For example, a manufacturer may have made their lenses available only to optical retailers, including mass merchandisers, optical chains, and wholesale clubs that offer substantial eye care services; or to independent ECPs, optical chains, and to some wholesale clubs and mass merchandisers that specialized in eye care services. In some instances, under these policies, sales were permitted to retailers where the retailer also sold contact lenses online through their own website.<sup>59</sup> Under these different distribution arrangements, pure online retailers were not permitted to purchase contact lenses through traditional and authorized wholesale channels, respectively.<sup>60</sup> Despite opinion that these restrictions made it more difficult to obtain the lenses,<sup>61</sup> according to the FTC, online retailers could obtain supplies on the “grey” market from retailers and distributors willing to resell their supplies of these lenses.<sup>62</sup>

**Restrictive pricing practices.** Restrictive pricing arrangements like the pricing practices at the center of the current debate have not been reported to be a part of prior distribution arrangements in the sale of contact lenses.<sup>63</sup> Beginning in 2013, reportedly contact lens manufacturers began introducing policies that restricted the resale prices of their products. These policies were first applied to new products, but over time have been applied to existing products by at least one manufacturer. The first manufacturer to introduce a policy that restricted the resale price of contact lenses was Alcon in 2013. The policy by Alcon was at first exclusively applicable to Alcon’s Dailies Total1 contact lenses. Subsequently in 2014, Alcon extended its UPP to other new products including Dailies AquaComfort Plus Toric, Dailies AquaComfort Plus Multifocal, and Air Optix Aqua Colors. Under Alcon’s UPP in the US, reportedly Alcon will not sell (or permit its authorized distributors to sell) applicable contact lens products to customer who resell or advertise the products for sale to patients at less than the price set by Alcon. In 2014, B&L also introduced a policy that restricted the resale price of contact lenses. B&L’s policy was applied to its new Ultra monthly disposable contact lenses. Under the policy, reportedly B&L will cease to supply, and will prohibit its authorized distributors from supplying B&L Ultra contact lenses to any customer that resells or advertises B&L Ultra contact lenses to the end consumer for sale at less than the price set by B&L. In 2014, JJVCI also adopted policies that restricted the resale prices of contact lenses. In JJVCI’s case, the policies applied to existing products including Acuvue Oasys, 1-Day Acuvue Moist, and 1-Day Acuvue TruEye contact lens designs. JJVCI was the first company to apply a restrictive price policy to products that had previously been on the market and sold without such restrictions. The company’s restriction of resale prices on existing products was accompanied by other changes including discontinuation of a manufacturer lens rebate program and new lens packaging. But for its application to existing

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<sup>57</sup> FTC (2005), 14.

<sup>58</sup> FTC (2005), 14.

<sup>59</sup> FTC (2005), 15.

<sup>60</sup> FTC (2005), 16.

<sup>61</sup> Atkinson (2014), 1 (“The doctors’-only contact lens marketing practice [a form of limited distribution] was designed to shield prescribers from competition, making the lenses more expensive and more difficult to obtain.”).

<sup>62</sup> FTC (2005), 16.

<sup>63</sup> Except as indicated, this section relies upon the reporting provided in S. Barry Eiden & Jordan Kassalow, *Impact of Unilateral Price Policies*, 29 CONTACT LENS SPECTRUM 36 (2014).

products, JJVCI's policy is reportedly similar to policies by other contact lens manufacturers. In 2014, CooperVision upheld an existing restricted pricing policy for its Calriti family of contact lenses after acquiring Safulon which had previously brought the daily disposable contacts to the U.S. market with a restrictive pricing policy earlier in the year.<sup>64</sup>

### Implications for the Current Debate

An important question in the current debate involves what influence various features of the contact lens industry will have on the assessment of manufacturers' restrictive pricing practices. Those complaining of these pricing practices point out that the retail distribution of contact lenses is distinguishable from other consumer products and that these distinctions distort competition in ways that are exacerbated by the pricing practices of contact lens manufacturers. Those in support of the manufacturer's pricing practices contend there are few differences and these differences do not impact competition nor are the implications of these differences exacerbated by manufacturers' pricing practices. Consequently, important questions concern these features and their effects for competition and consumers when combined with the pricing practices of contact lens manufacturers.

**Distinctive features of the retail distribution of contact lenses.** Various features of the retail distribution of contact lenses are unique to the contact lens industry.<sup>65</sup> These features are extensively described by members of the industry<sup>66</sup> and others.<sup>67</sup> Together these features are

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<sup>64</sup> Nancy Hemphill, Healio.com, *CooperVision institutes UPP for Clariti contact lenses* (2014), <http://www.healio.com/optometry/contact-lenses-eye-wear/news/online/%7Bc63ded7b-af8c-4df7-9c44-ca234baafd10%7D/coopervision-institutes-upp-for-clariti-contact-lenses>.

<sup>65</sup> Patrice M. Arent, Utah State House of Representatives, *Utah Senate Bill 169 Hearing*, 12 (2015) ("These factors make the sale of contact lenses very different than other products."). Atkinson (2014), 1 (Describing that the "... the optometry industry is different for several reasons."). Thomas (undated) ("Just by way of background, contact lenses are a unique medical device in that ...."). Amy Klobuchar, U.S. Senator, *Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?*, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights, 3 (2014) ("We also know that contact lenses are not typical retail products like computers or televisions or laundry detergents ...").

<sup>66</sup> Thomas (undated) ("Just by way of background, contact lenses are a unique medical device in that they are sold by the prescriber. So an optometrist is not only a healthcare provider, similar to a medical provider, but they're also a retailer. So that's a difference in healthcare markets, the ocular health versus the medical market. And unlike the market in the medical world where a prescriber then hands off to a pharmacy the actual dispensing of the product , in this industry an optometrist actually acts as a pharmacist, if you will , or a retailer and sells the product . The other difference in this industry from many, many other medical devices is that the actual brand that you can wear is on the prescription that you receive from your provider. So that means that you receive a specific brand in your prescription. And so after you've paid for your exam and paid for an additional fee to be fit for a contact lens, you ' re given a prescription that allows you to only buy one product with no switching, no changes, etc . And that's important to understand because it means that a healthcare provider will determine in 90 percent of the time what brand of contact lenses you wear."). Garth Vincent, Attorney Munger, Tolles & Olsen, *Washington Senate Bill 5489 Hearing*, 17 (2015) ("So optometrists are unique...").

<sup>67</sup> Atkinson (2014), 1 (Describing under the heading "The Unique Nature of the Optometry Industry" that "... the optometry industry is different for several reasons. First, before a consumer can purchase contact lenses, he or she must first get permission from a gatekeeper (an optometrist) with a financial interest in the consumer's choice. ... Second, contact lenses are a —credence good where consumers have a difficult time in judging the quality of the product."). Arent (2015), 11-12 ("First, before you can purchase lenses, you have to pay an eye care professional to perform an eye exam and write a prescription. That prescription is for a specific brand of contact lenses. Substitution is prohibited by the federal law I mentioned. That means there's no inter brand competition for contact lenses. Third, once the brand is pre scribed, the consumer is effectively barred from switching to an alternative without paying for a brand new prescription. And then, fourth, eye care professionals can sell contact lenses. And I think they're the



suggested to effect competition<sup>68</sup> and to make the industry susceptible to anticompetitive practices.<sup>69</sup>

*Prescriptions for contact lenses are brand-specific.* One distinguishable feature of the retail distribution for contact lens industry is that prescriptions for contact lenses are typically brand-specific. When fitting contact lenses an ECP generally prescribes a specific brand of contact lens that their patients must purchase to fill their prescription.<sup>70</sup> ECPs control the prescribing process and consumers rely on their ECP to select a lens for them. Consequently, members of the industry identify ECPs as “gatekeepers,”<sup>71</sup> discuss how patients are “locked in”<sup>72</sup> to a specific brand, and describe that consumers incur significant “switching costs”<sup>73</sup> given they must obtain a different prescription or visit another ECP if they desire a different brand. At the consumer level, this feature of distribution forecloses (or at minimum greatly limits) downstream interbrand competition between different brands of contact lenses. Given this foreclosure, remaining competition involves intrabrand competition among retailers that sell contact lenses<sup>74</sup> and upstream interbrand competition between manufacturers vying for the patronage of ECPs in prescribing their brands.

*ECPs can both prescribe and sell contact lenses.* A second distinguishable feature of contact lens distribution is that ECPs can both prescribe and sell contact lenses. Upon fitting a patient with a particular brand of contact lens, an ECP may also sell the contact lens they have

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only medical professional I know who sells what they prescribe. Fifth, there are no generics. And, sixth, since a few contact lens makers control over 90 percent of the market and their sales are effectively determined by the prescribers, they have an incentive to appeal to the prescribers' financial interests. These factors make the sale of contact lenses very different than other products.”). Vincent (2015), 17 (“So optometrists are unique in that for historical reasons that no longer apply, they're able to sell what they prescribe”).

<sup>68</sup> Arent (2015), 11 (“So I've spent some time thinking about this industry. And unlike most markets for consumer goods, it has characteristics that make it particularly resistant to competition.”).

<sup>69</sup> Arent (2015), 12 (Describing six features that distinguish the contact lens industry “These factors make the sale of contact lenses very different than other products. They are susceptible to anticompetitive activities.”). Denial of Manufacturers' Preliminary Injunction Motions, Utah (Judge Benson describes that “The contact lens industry has two features that make it particularly susceptible to anticompetitive conduct.”).

<sup>70</sup> Thomas (undated), 3 (“The other difference in this industry from many, many other medical devices is that the actual brand that you can wear is on the prescription that you receive from your provider. So that means that you receive a specific brand in your prescription.”). MaGure (2015), 16 (Describing that prescriptions are by brand: “They are 100 percent by brand. That's federal law.”). Plattner (2015), 17 (Responding to the question so when you write a prescription, you write the prescription by brand: “That's correct.”). Monroe (2015), 2 (“Contacts can't be purchased without a prescription, which includes the exact brand and model you must buy, and cannot be substituted. No generic. Once prescribed, a patient cannot switch brands without paying for another fitting. This means that increased costs are paid entirely by the patient.”). Kevin Demena, DeMena & Associates, Arizona Legislative Session, *House Bill 2038 Hearing*, 9 (2015) (Describing a contact lens prescription “This is brand specific. Federal law requires that.”).

<sup>71</sup> Thomas (undated), 23 (“This is a market where the gatekeeper is the optometrist.”).

<sup>72</sup> Jay MaGure, 1-800 Contacts, Idaho Legislative Session, *House Bill 149 Hearing*, 16 (2015) (“The patient is locked into this brand for the duration of this prescription.”). Bryan Kohler, 1-800 Contacts, Oregon Senate Committee on Judiciary, *Senate Bill 933Hearing*, 2 (2015) (“Currently the practice is that the consumer is locked into that particular lens.”).

<sup>73</sup> Klobuchar (2014), 3 (“In addition, there may be limits on which specific contact lenses a consumer can wear and significant costs required to switch contact lenses in response to pricing changes.”).

<sup>74</sup> Klobuchar (2014), 5 (Describing the effects of the unique nature of distribution for contact lenses: “so this is a market where retail competition may be the only competition in the market.”).

prescribed for their patient.<sup>75</sup> This feature of distribution encourages ECPs to sell contact lens, which they typically do,<sup>76</sup> and thereby increases intrabrand competition between ECPs and other retail channels of distribution that also sell contact lenses. Thus, members of the industry further identify ECPs as “gatekeepers,”<sup>77</sup> discuss “capture rates”<sup>78</sup> and describe strategies for selling and profiting from the sales of contact lenses. This feature of distribution also creates a conflict of interest on the part of ECPs that both prescribe and sell contact lens.<sup>79</sup> As summarized by one long-time observer, “The contact lens industry is unique in that optometrists are allowed to sell what they prescribe. They have a conflict of interest. Do they prescribe what’s best for the patient as a professional, or do they prescribe what’s most lucrative for the optometrist as a retailer?”<sup>80</sup>

*Patients lack knowledge to choose their own contact lenses.* A third distinguishable feature of contact lens distribution is that patients lack the specialized knowledge necessary to choose their own contact lenses. According to the FTC consumers can easily determine the cost of the eye examination in advance,<sup>81</sup> but consumers likely cannot easily determine the price of the contact lenses prescribed for them in advance because they lack the specialized knowledge necessary to determine which lens is appropriate for them.<sup>82</sup> Thus, contact lenses have been described as a “...credence good where consumers have a difficult time in judging the quality of the product.”<sup>83</sup> Moreover, as determined by the FTC, consumers must rely on an ECP to select a lens that safely and comfortably corrects their vision.<sup>84</sup> Despite that advertising and other information may help to educate consumers, according to the FTC, ECPs likely possess more information concerning the relative quality of a particular lens.<sup>85</sup> Consequently, consumers find it difficult to second-guess their ECPs advice<sup>86</sup> and the FTC has concluded that when purchasing

<sup>75</sup> Vincent (2015), 17 (“So optometrist are unique in that for historical reasons that no longer apply, they’re able to sell what they prescribe.”).

<sup>76</sup> Klobuchar (2014), 5 (“Eye care professionals also typically sell the contact lenses that they prescribe ...”).

<sup>77</sup> Jacob Anderegg, Utah House of Representatives District 6, *Utah Senate Bill 169 Hearing*, 12 (2015) (“But in this instance, the gatekeeper are the optometrists. You have to go in with a prescription, which narrows the scope of your ability to go out and shop.”).

<sup>78</sup> Alexander, Johnson & Johnson, Oregon Senate Committee On Judiciary, *Senate Bill 933 Hearing*, 39 (2015) (“When the president of a company is speaking to a customer group, which happens. ... We talk about capture rate, for example.”). Vision Monday, *Johnson & Johnson Vision Care Introduces Unilateral Pricing Policy on ‘Strategic Brand’ CLs, Discontinues Some Acuvue Brands* (July 2, 2014) (quoting Laura, Angelini, Johnson & Johnson: “[UPP] ... gives the optometrist the ability to improve his or her capture rate in the office. Now the patient has no incentive to shop around.”).

<sup>79</sup> A conflict of interest is commonly defined to involve a situation in which a person is in a position to derive personal benefit from actions or decisions made in their official capacity. Klobuchar (2014), 3 (“Eye care professionals also typically sell the contact lenses that they pre scribe creating the potential for a conflict of interest.”).

<sup>80</sup> Vincent (2015), 17 (“The contact lens industry is unique in that optometrists are allowed to sell what they prescribe. They have a conflict of interest. Do they prescribe what’s best for the patient as a professional, or do they prescribe what’s most lucrative for the optometrist as a retailer?”).

<sup>81</sup> FTC (2005), 16.

<sup>82</sup> FTC (2005), 16.

<sup>83</sup> Atkinson (2014), 1 (Describing that “... contact lenses are a —credence good where consumers have a difficult time in judging the quality of the product.”).

<sup>84</sup> FTC (2005), 16.

<sup>85</sup> FTC (2005), 16.

<sup>86</sup> Atkinson (2014), 1 (“If a doctor tells a patient that a particular lens is the right one for her, who is she to second-guess her health care professional?”).

contact lenses “patients want their ECPs to prescribe for them a contact lens that represents their preferred combination of price and quality.”<sup>87</sup>

**Introduction of minimum retail price practices.** The introduction of manufacturers pricing practices to the aforementioned features of the retail distribution and consumer purchase of contact lenses affects competition and consumers in various ways.

**Distortions to intrabrand competition.** Manufacturers’ retail price practices require that retailers sell the manufacturer’s brand of contact lens at, or above, a minimum price. The introduction of such pricing practices to the sale of contact lenses restricts intrabrand price competition<sup>88</sup> and forces retailers to focus on non-price competition. Describing how this occurs and benefits to practitioners of restrictive pricing practices, Gary Gerber an OD writing in the Review of Cornea and Contact Lens writes, “One of the biggest benefits to practitioners of UPP is that it instantly creates a level playing field; volumes discounts for large practices and online retailers go away. While this may create friction with buying groups, the benefits outweigh any ancillary issues. More importantly, however, it forces practices to focus on something other than price to keep prescriptions in their office – if all retailers sell the lenses for the same price, the method and environment under which they are sold will be the factors that determine where a patient decides to purchase their lenses.”<sup>89</sup> As concluded by Dr. Gerber, “With pricing nearly neutralized (but not completely neutralized, as a practice can charge more than the required UPP)

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<sup>87</sup> FTC (2005), 16.

<sup>88</sup> Commission on the European Communities, *Commission Notice: Vertical Restraint Guidelines*, ¶224 (2010) (Describing the effects of RPM on competition including intrabrand competition “RPM may restrict competition in a number of ways. Firstly, RPM may facilitate collusion between suppliers by enhancing price transparency in the market, thereby making it easier to detect whether a supplier deviates from the collusive equilibrium by cutting its price. RPM also undermines the incentive for the supplier to cut its price to its distributors, as the fixed resale price will prevent it from benefiting from expanded sales. This negative effect is in particular plausible if the market is prone to collusive outcomes, for instance if the manufacturers form a tight oligopoly and a significant part of the market is covered by RPM agreements. Secondly, by eliminating intra-brand price competition, RPM may also facilitate collusion between the buyers, i.e. at the distribution level. Strong or well organized distributors may be able to force/convince one or more suppliers to fix their resale price above the competitive level and thereby help them to reach or stabilise a collusive equilibrium. This loss of price competition seems especially problematic when the RPM is inspired by the buyers, whose collective horizontal interests can be expected to work out negatively for consumers. Thirdly, RPM may more in general soften competition between manufacturers and/or between retailers, in particular when manufacturers use the same distributors to distribute their products and RPM is applied by all or many of them. Fourthly, the immediate effect of RPM will be that all or certain distributors are prevented from lowering their sales price for that particular brand. In other words, the direct effect of RPM is a price increase. Fifthly, RPM may lower the pressure on the margin of the manufacturer, in particular where the manufacturer has a commitment problem, i.e. where he has an interest in lowering the price charged to subsequent distributors. In such a situation, the manufacturer may prefer to agree to RPM, so as to help it to commit not to lower the price for subsequent distributors and to reduce the pressure on its own margin. Sixthly, RPM may be implemented by a manufacturer with market power to foreclose smaller rivals. The increased margin that RPM may offer distributors, may entice the latter to favour the particular brand over rival brands when advising customers, even where such advice is not in the interest of these customers, or not to sell these rival brands at all. Lastly, RPM may reduce dynamism and innovation at the distribution level. By preventing price competition between different distributors, RPM may prevent more efficient retailers from entering the market and/or acquiring sufficient scale with low prices. It also may prevent or hinder the entry and expansion of distribution formats based on low prices, such as price discounters.” Emphasis added).

<sup>89</sup> Gary Gerber, Optometrist, *What’s UPP, Doc?*, REVIEW OF CORNEA & CONTACT LENSES 34 (June 15, 2014).

across all practices, the loss of a contact lens order can no longer be attributed to price competition.”<sup>90</sup>

*Distortions to interbrand competition.* When combined with the conflict of interest encountered by ECPs that both prescribe and sell contact lenses, manufacturers’ retail price practices distort interbrand competition by shielding manufacturers from the effects of aggressive retail price competition<sup>91</sup> and by encouraging ECPs to favor price restricted lenses over clinically equivalent, but less costly options for their patients.<sup>92</sup> Outlining these effects Dr. Gerber writes, “Manufacturers also benefit from UPP because retail price erosion can be stopped. With a ‘race to the bottom’ from aggressive price cutting eliminated, motivations to fit a particular lens increase; this has the ability to support and protect brand equity.”<sup>93</sup> Dr. Gerber further writes, “All things being clinically equal (which of course they rarely are), savvy practitioners will give serious thought to prescribing UPP lenses. For example, if you have a patient with astigmatism and they can wear a UPP lens, and a non-UPP lens is clinically equivalent, a smart doctor will choose the UPP option.”<sup>94</sup>

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<sup>90</sup> Gerber (2014), 34.

<sup>91</sup> Commission on the European Communities (2010), ¶224 (Describing the effects of RPM on competition including interbrand competition “RPM may restrict competition in a number of ways. Firstly, RPM may facilitate collusion between suppliers by enhancing price transparency in the market, thereby making it easier to detect whether a supplier deviates from the collusive equilibrium by cutting its price. RPM also undermines the incentive for the supplier to cut its price to its distributors, as the fixed resale price will prevent it from benefiting from expanded sales. This negative effect is in particular plausible if the market is prone to collusive outcomes, for instance if the manufacturers form a tight oligopoly and a significant part of the market is covered by RPM agreements. Secondly, by eliminating intra-brand price competition, RPM may also facilitate collusion between the buyers, i.e. at the distribution level. Strong or well organized distributors may be able to force/convince one or more suppliers to fix their resale price above the competitive level and thereby help them to reach or stabilize a collusive equilibrium. This loss of price competition seems especially problematic when the RPM is inspired by the buyers, whose collective horizontal interests can be expected to work out negatively for consumers. Thirdly, RPM may more in general soften competition between manufacturers and/or between retailers, in particular when manufacturers use the same distributors to distribute their products and RPM is applied by all or many of them. Fourthly, the immediate effect of RPM will be that all or certain distributors are prevented from lowering their sales price for that particular brand. In other words, the direct effect of RPM is a price increase. Fifthly, RPM may lower the pressure on the margin of the manufacturer, in particular where the manufacturer has a commitment problem, i.e. where he has an interest in lowering the price charged to subsequent distributors. In such a situation, the manufacturer may prefer to agree to RPM, so as to help it to commit not to lower the price for subsequent distributors and to reduce the pressure on its own margin. Sixthly, RPM may be implemented by a manufacturer with market power to foreclose smaller rivals. The increased margin that RPM may offer distributors, may entice the latter to favour the particular brand over rival brands when advising customers, even where such advice is not in the interest of these customers, or not to sell these rival brands at all. Lastly, RPM may reduce dynamism and innovation at the distribution level. By preventing price competition between different distributors, RPM may prevent more efficient retailers from entering the market and/or acquiring sufficient scale with low prices. It also may prevent or hinder the entry and expansion of distribution formats based on low prices, such as price discounters.” Emphasis added).

<sup>92</sup> Atkinson (2014), 1 (Citing James Cooper, Public versus Private Restraints on the Online Distribution of Contact Lenses: A Distinction with a Difference at the George Mason University Mercatus Center symposium on Anticompetitive Barriers to E-Commerce, May 24, 2006, (Quoting an FTC staff member: “ECPs (eye care professionals) have an incentive to prescribe the lens that provides them with the most profit.”).

<sup>93</sup> Gerber (2014), 34.

<sup>94</sup> Gerber (2014), 34.

**Consequences for consumers.** A consequence of the introduction of restrictive pricing practices to the unique features of the contact lens industry is that consumers may pay more for their contact lenses. With the retail price competition of affected brands restricted through manufacturers pricing practices, remaining competition involves non-price competition among retailers that sell contact lenses and interbrand competition between manufacturers vying for the patronage of ECPs in prescribing their particular brands. However, this competition is distorted by manufacturers pricing practices in ways that can lead to higher prices for consumers. Intrabrand competition among retailers is affected given ECPs are encouraged to prescribe price restricted brands to their patients in order to avoid aggressive price competition from other retailers. Interbrand competition among manufacturers is affected given ECPs are encouraged to prescribe price restricted brands that are more profitable to them.<sup>95</sup> Together, these distortions benefit ECPs and manufacturers by shielding their profit margins from lower prices and price competition, but harm retailers and consumers that favor lower prices and price competition. Because patients lack specialized knowledge of contact lens and rely upon their ECPs to choose a contact lens for them, a patient's personal knowledge and their ability to choose is no longer effective as a counterweight to these distortions.<sup>96</sup> Thus, as Dr. Gerber concludes relative to patient prices, "yes they may pay more as a result," however, "it's great for your [the ECP's] practice and the industry."<sup>97</sup> According to Dr. Gerber, these conclusions are supported because the initial prices and price margins of price restricted lenses are higher than prices and margins for unrestricted lenses. As Dr. Gerber describes, "Finally, the actual price mandated by UPP has so far been higher than lenses that do not have a UPP. This has afforded higher profit margins and created a new sense of excitement surrounding contact lenses."<sup>98</sup>

### Directions for Analysis

Analyses that bear in mind the aforementioned insights should be helpful to ongoing assessments of the competitive implications of contact lens manufacturers' pricing practices. To the extent the described effects are supported by analyses that incorporate data obtained through the rigors of the legal process and complementary methodologies, they bolster the importance of understanding the unique features of the retail distribution for contact lenses when assessing the competitive effects of manufacturers pricing practices. Subsequent analyses should elaborate upon these distinctive features and drawing on comparative data and analysis, substantiate the difference of contact lenses from other consumer products. Incorporating knowledge from economics and business, these analyses should then more particularly trace and expound upon the distortions that these features pose for the different forms of competition found in the industry. Once understood, additional analyses should describe and assess in more particular detail, the effects for competition and consumers that result from the introduction of minimum resale prices. For this understanding, knowledge of RPM found in economics and related fields

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<sup>95</sup> Recognizing these effects, in order to maintain or to gain the patronage of ECPs in prescribing their brands, other manufacturers are also encouraged to offer price restricted brands.

<sup>96</sup> Klobuchar (2014), 3 ("We also know that contact lenses are not typical retail products like computers or televisions or laundry detergents, where consumers drive all of the choices, so they can decide which product or which brand to purchase."). Atkinson (2014), 1 ("As a result, because of the unique nature of this market, consumer choices will not serve as a counter-weight to the optometry profession's anti-consumer, anti-competitive practices.").

<sup>97</sup> Gerber (2014), 34.

<sup>98</sup> Gerber (2014), 34.



should be helpful. In addition, more general understanding of distribution, distribution channels and distribution arrangements found in business should be of assistance.

## HISTORICAL CONTEXT

### History of Inter-Channel Conflict

The contact lens industry has experienced a long history of conflict between traditional resellers in the form of eye care professionals (ECPs) and newer alternative forms of retail distribution. Major contact lens manufacturers and their ECPs have been repeatedly assailed for engaging in practices<sup>99</sup> designed to restrict the availability of contact lenses offered through new forms of retail distribution.<sup>100</sup> This conflict and these charges have led to private and public actions involving manufacturers and ECPs on the one side, and on the other, mail order houses and pharmacies, and most recently, wholesale clubs, discount retailers, and Internet retailers. These actions have resulted in findings, legislation, workshops, reports, studies, hearings, investigations, verdicts, and fines addressing the actions of contact lens manufacturers and ECPs. This history of conflict and these outcomes offer important context for understanding the competitive implications of contact lens manufacturers' pricing practices.

**In re disposable lenses.** In the 1990s, consumers and 31 state Attorney Generals filed lawsuits against major manufacturers and the ECPs' professional association alleging that they "conspired among themselves ... to restrict the supply of replacement contact lenses to alternative channels of distribution."<sup>101</sup> At the time, this included retail distribution of contact lenses through mail-order houses and pharmacies. According to the complaint, manufacturers and their professional association conspired to restrict wholesale sales to these "alternative suppliers" and in the absence of their conspiracy to do so, consumers would have paid lower prices for contact lenses. According to documents in the case, manufacturers and ECPs had become concerned about sales of contact lenses being diverted from ECPs to the mail order houses and pharmacies. In response the manufacturers and ECPs developed and implemented an action plan that included reducing the supply and demand for diverted products through the new channels, and to facilitate their effort, disguise contact lens prescriptions from consumers. In denying summary judgment motions by manufacturers, the district court detailed extensive evidence that ECPs "threatened an economic boycott" of contact lens manufacturers if they "sold to alternative channels of distribution," along with evidence that manufacturers acquiesced to those threats.<sup>102</sup> A settlement was reached in the case after several weeks of trial through which manufacturers and the association paid millions of dollars and agreed not to engage in discriminatory

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<sup>99</sup> Garth Vincent, Attorney Munger, Tolles & Olsen, Arizona Legislative Session, *House Bill 2038 Hearing*, 18 (2015) ("There's been a long and unfortunate history in our industry of contact lens manufacturers trying to financially induce, some might say bribe, optometrists to pre scribe their brand of contact lenses by promising to shield them from competition by discounters . They've done that through various means. This included agreements not to supply lenses to discounters. Tactics to prevent consumers from getting access to their prescriptions that they need to be able to buy lenses from someone other than their optometrist. Bogus health claims that it was somehow dangerous or there are health risks from buying lenses from someone other than your optometrist.").

<sup>100</sup> Atkinson (2014), 1 ("One industry that has had a long practice of employing such barriers to limit consumer choice is optometry. Optometrists have lobbied for anti-competitive state laws and engaged in anti-competitive behavior in order to restrict their customers from buying contact lens from other channels, including online and —big box retailers.").

<sup>101</sup> *In re Disposable Contact Lens Antitrust Litig.*, MDL No. 1030, 2001 WL 493244 (M.D. Fla Feb. 1, 2001).

<sup>102</sup> *In re Disposable Contact Lens Antitrust Litig.* (2001).

distribution.<sup>103</sup> The settlement included broad injunctive relief requiring the manufacturers to sell contact lenses to non-ECP retailers in a “commercially reasonable” and “non-discriminatory” manner for at least five years.<sup>104</sup>

**Fairness to Contact Lens Consumers Act.** In 2003, in response to concerns that consumers were not being allowed fair access to alternative channels of distribution when purchasing contact lenses, the Fairness to Contact lens Consumers Act (FCLCA) was signed into the law.<sup>105</sup> Effective in 2004, the FCLCA was enacted to enhance competition in the market for contact lenses by providing consumers with a greater ability to fill their contact lens prescriptions from sellers other than their prescribing eye care practitioner. The Act, along with regulations by the FTC designed to implement the FCLCA<sup>106</sup> impose on prescribers and sellers requirements intended to enhance prescription portability. Among other things, as a result of the Act, ECPs are required to release a contact lens prescription to a patient and may not tie the prescription release to the purchase of lenses from the ECP. Despite these requirements, subsequent patient surveys find that ECPs do not always release contact lens prescriptions to their patients resulting in continuing conflict.<sup>107</sup>

**FTC workshop on possible anticompetitive efforts to restrict competition on the Internet.** In 2002, the Federal Trade Commission held a public workshop to evaluate possible anticompetitive barriers to e-commerce in contact lenses and nine other industries.<sup>108</sup> Among the conclusions reached by the Commission staff regarding online contact lens sales was that “The release of contact lens prescriptions by eye care providers facilitates consumer choice in replacement contact lens suppliers, and greater consumer choice increases consumer welfare.”<sup>109</sup>

**FTC Report on Possible Anticompetitive Barriers to E-Commerce: Contact Lenses.** In 2004, the Federal Trade Commission issued a report analyzing potential anticompetitive barriers to Internet commerce in contact lenses.<sup>110</sup> Among the findings, the FTC found that following the advent of disposable soft contact lenses there have been “growth in the non-practitioner lens sellers such as Internet-based contact lens retailers” and that both had “changed the market dynamics” of the contact lens industry.<sup>111</sup> Moreover, “these changes have caused

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<sup>103</sup> In re Disposable Contact Lens Antitrust Litig. (2001), Settlement Agreement with Johnson & Johnson Vision Care, Inc., MDL Docket No. 1030, § 7, <http://apps.americanbar.org/antitrust/at-committees/at-state/pdf/settlements/us-district/11th-circuit/jjsettle.pdf>. Settlement Agreement with Bausch & Lomb, MDL Docket No. 1030, § 6, <http://apps.americanbar.org/antitrust/at-committees/at-state/pdf/settlements/us-district/11th-circuit/blsettle.pdf>.

<sup>104</sup> In re Disposable Contact Lens Antitrust Litig. (2001). Settlement Agreement with Johnson & Johnson Vision Care, Inc..

<sup>105</sup> FCLCA (2004).

<sup>106</sup> The Contact Lens Rule 69 Fed. Reg. 40481 (July 2, 2004) (codified at 16 C.F.R. Part 315).

<sup>107</sup> Contact Lens Spectrum, *Annual Report*, (2008) (“[o]ur reader survey also indicates that despite this federal legislation, only half of the respondents replied ‘yes, to every patient’ when asked if they release contact lens prescriptions.”).

<sup>108</sup> Federal Trade Commission, *FTC Releases Agenda for Public Workshop on Possible Anticompetitive Efforts to Restrict Competition on the Internet* (2002), <https://www.ftc.gov/news-events/press-releases/2002/09/ftc-releases-agenda-public-workshop-possible-anticompetitive>.

<sup>109</sup> Federal Trade Commission (2004), 4.

<sup>110</sup> FTC (2004).

<sup>111</sup> FTC (2004), 1.

tension among eye care practitioners, bricks-and-mortar lens sellers, contact lens manufacturers, Internet lens sellers, and state officials over issues such as licensing contact lens sellers, contact lens prescription release requirements, and methods of verifying prescriptions.”<sup>112</sup> As concluded by the FTC, “[n]on-traditional contact lens sellers, such as Internet and mail order providers, represent a unique alternative distribution channel and offer some consumers a combination of price and convenience that they value highly.”<sup>113</sup> Further, according to the FTC “consumers can often achieve significant savings by purchasing replacement lenses from sellers other than their eye care providers...”<sup>114</sup> Other issues identified and involving nontraditional distribution channels included the practice of eye care practitioners writing prescriptions for lenses that are not available from other lens sellers (i.e., private label lenses.)<sup>115</sup>

**The Strength of Competition in the Sale of Rx Contact Lenses: An FTC Study.** In 2005, in a follow-up required by the FCLCA, the FTC conducted and published a study entitled “The Strength of Competition in the Sale of Rx Contact Lenses: An FTC Study.”<sup>116</sup> As a part of the study, the FTC examined the competitive impact of policies by manufacturers that limited the distribution channels through which they sell their contact lenses including Internet retailers. The FTC concluded that, based upon available information, the relationships did not limit competition or harm consumers through supra-competitive prices. The FTC found that the ten most popular contact lenses were widely available, but that prices varied across channels.<sup>117</sup> According to the FTC, independent ECPs and optical chains offered the highest prices, and wholesale clubs offered the lowest prices.<sup>118</sup> Not accounting for intra-channel differences, the FTC determined that contact lenses sold online were on average \$15 less expensive (based upon a 6-month supply) than those sold offline.<sup>119</sup>

**House hearing on Contact Lens Sales: Is Market Regulation the Prescription?** In 2006, investigating distribution practices involving conflicts between alternative channels of distribution, the Commerce, Trade and Consumer Protection Subcommittee of the House Energy and Commerce Committee held a hearing entitled “Contact Lens Sales: Is Market Regulation the Prescription?”<sup>120</sup> The concerns that precipitated the hearing arose because some manufacturers (namely Cooper Vision) sold their lenses exclusively to ECPs. Aftercare providers occupying alternative channels of distribution including Internet retailers complained that such arrangements limited competition and ultimately harmed consumers.<sup>121</sup>

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<sup>112</sup> FTC (2004), 1.

<sup>113</sup> FTC (2004), 12.

<sup>114</sup> FTC (2004), 13.

<sup>115</sup> FTC (2004), 8 (“Private label brands” involve arrangements where a retail seller sold a national name brand under a different name including a name unique to that seller (e.g., Wal-Mart, Pearle Vision, Target, Lens Crafters). These differ from “private brands” that are unique and exclusive to the seller.).

<sup>116</sup> FTC (2005).

<sup>117</sup> FTC (2005), 34, 60.

<sup>118</sup> FTC (2005), 34, 60.

<sup>119</sup> FTC (2005), 42.

<sup>120</sup> U.S. House of Representatives, *Contact Lens Sales: Is Market Regulation the Prescription?*, Committee on Energy and Commerce, Subcommittee on Commerce, Trade and Consumer Protection (2006), <http://www.gpo.gov/fdsys/pkg/CHRG-109hhrg31465/html/CHRG-109hhrg31465.htm>.

<sup>121</sup> Cliff Stearns, U.S. House of Representatives, *Contact Lens Sales: Is Market Regulation the Prescription?*, Committee on Energy and Commerce, Subcommittee on Commerce, Trade and Consumer Protection (2006), <http://www.gpo.gov/fdsys/pkg/CHRG-109hhrg31465/html/CHRG-109hhrg31465.htm>.



**German Federal Cartel Office price fixing investigation.** In 2009, after an investigation, the German Federal Cartel Office imposed a fine of E11.5 million against one manufacturer, CIBA vision Vertriebs GMBH (CIBA) for fixing minimum resale prices of contact lenses and restricting internet and wholesale prices of its contact lenses. The manufacturer was found to have utilized an internal “price maintenance” program whereby it enforced minimum resale prices for contact lenses in violation of European Community and German Law.<sup>122</sup> Reportedly, under this program CIBA employees “systematically monitored retail prices for CIBA contact lenses charged by internet retailers to consumers.”<sup>123</sup> Where contact lenses were priced more than 10–15% below CIBA’s recommended retail prices (in the case of product launches, more than 10% below), CIBA staff would approach those internet retailers to convince them to increase their prices.<sup>124</sup> In addition, CIBA “requested its retailers to sign written consents whereby the retailer would commit not to sell certain CIBA contact lenses via the internet.”<sup>125</sup> CIBA also prevented sales of CIBA lenses via eBay by asking eBay to delete any mention of its products on eBay’s website.<sup>126</sup> In addition, CIBA agreed with at least four of its major wholesalers that they should not sell contact lenses to other retailers.<sup>127</sup>

**China National Development and Reform Commission anti-monopoly investigation.** More recently, in 2014, several contact lens manufacturers were fined by China’s National Development and Reform Commission for violating China’s Anti-Monopoly Law.<sup>128</sup> Among other practices, the manufacturers were found to have adopted RPM policies and required retailers to adhere to the policies. Reportedly, the companies required dealers to set lens prices at a “suggested level” above the minimum price that vision care-related products can be sold for.<sup>129</sup> In addition, “retailers were ordered to coordinate promotion of products across all major Chinese cities throughout the year in efforts to stabilize prices.”<sup>130</sup> This included promotions such as “Buy 3 Get 1 Free” that would have otherwise lowered prices.<sup>131</sup> The mandates were paired with undisclosed penalties and threats to stop oversea distribution of supplies to pressure retailers and dealers.<sup>132</sup>

**Senate hearing on Pricing Policies and Competition in the Contact Lens Industry.** In 2014, the subcommittee of the U.S. Senate committee on the Judiciary held hearings on pricing practices and competition occurring in the contact lens industry.<sup>133</sup> The hearing examined policies recently adopted by the contact lens manufacturers requiring retailers to sell certain

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<sup>122</sup> Tobias Caspary, *Swimming against the Zeitgeist? German Federal Cartel Office issues Third Fine for Resale Price Maintenance (CIBA)*, 3 EUROPEAN COMPETITION LAW REVIEW 125 (2010).

<sup>123</sup> Caspary (2010), 125.

<sup>124</sup> Caspary (2010), 125.

<sup>125</sup> Caspary (2010), 125.

<sup>126</sup> Caspary (2010), 125.

<sup>127</sup> Caspary (2010), 125.

<sup>128</sup> Shaila Huq & Dave Schatz, *Johnson and Johnson Fined for Fixing Prices in China*, NEW BRUNSWICK TODAY (2014), <http://newbrunswicktoday.com/article/johnson-and-johnson-fined-fixing-prices-china>.

<sup>129</sup> Huq (2014).

<sup>130</sup> Huq (2014).

<sup>131</sup> Visionmonday.com, *China Fines Eyeglass Lens and Contact Lens Makers for Alleged Price Fixing* (2014), <http://www.visionmonday.com/latest-news/article/china-fines-eyeglass-lens-and-contact-lens-makers-for-alleged-price-fixing-1/>.

<sup>132</sup> Huq (2014).

<sup>133</sup> Randles (2015).

contact lenses at or above a specified price. According to published reports, the hearing was intended as an exploratory effort to give the subcommittee and regulators a better understanding of the reasons for the minimum pricing arrangements in the contact lens market.<sup>134</sup> As of 2015, each of the four major contact lens manufacturers has implemented this type of pricing arrangement for at least some of its products.

### Current Lawsuits

Most recently, numerous (more than 50) lawsuits involving disputes concerning alternative distribution channels have been filed. These lawsuits assert that the restrictive pricing practices found in the contact lens industry violate federal and state antitrust laws. These lawsuits include allegations of antitrust violations on the part of all four of the leading manufacturers, a leading wholesaler, and some retailers of contact lenses. The lawsuits have since been consolidated by the U.S. Judicial Panel on Multidistrict Litigation to the Middle District of Florida.<sup>135</sup> At least two types of class action lawsuits are distinguishable.

**Manufacturers and wholesalers.** One type of class action complaint is reflected in *Machikawa v. Cooper Vision, Inc., et al.*, which was filed March 3, 2015 against the four largest manufacturers (i.e., Alcon Laboratories, Inc.; Bausch & Lomb; Johnson & Johnson; Vison Care, Inc. and Cooper Vision, Inc.) and a large wholesaler (ABB Group).<sup>136</sup> The lawsuit contends that the companies and wholesaler conspired with independent optometrists and ophthalmologists to eliminate low-priced competition from big-box retailers and Internet distributors. According to the complaint, the defendants allegedly accomplished this goal by requiring resellers of contact lenses to charge minimum retail prices through so-called “Unilateral Pricing Policies” (UPPs). As alleged by the plaintiffs, the disposable contact lens market is subject to distortion based on the fact that there are two types of retailers of lenses: (1) eye-care professionals, including optometrists and ophthalmologists, who both prescribe and sell lenses, and (2) discount sellers, including big-box retailers, such as Costco and Wal-Mart and Internet resellers, such as 1-800-Contacts. The plaintiffs allege that the manufacturers and wholesaler set UPPs in consultation with ECPs with a goal of protecting the ECPs and resulting in harms to consumers. According to the plaintiffs, the UPPs are illegal RPM agreements in violation of the Sherman Act.<sup>137</sup>

**Manufacturers, wholesalers, and retailers.** Another type of class action is captured in *Serge Pentsak et al. v. CooperVision Inc. et al*, which was filed March 10, 2015 against manufacturers, wholesalers and retailers of contact lenses. The claimants allege that the four largest manufacturers conspired with each other and with wholesaler ABB Concise Optical Group, as well as ECPs represented by ABB Group and their trade association, the American Optometric Association, to impose illegal minimum retail price or RPM policies.<sup>138</sup> However, in addition, the lawsuit claims that manufacturers then conspired with retailers and obtained agreements from them to abide by these policies, prohibiting other retailers from discounting products.<sup>139</sup>

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<sup>134</sup> Randles (2015).

<sup>135</sup> Irvin Jackson, *MDLs Established for Contact Lens and Lenova Adware Litigation, But Not California Wine Lawsuits*, ABOUTLAWSUITS.COM (2015), <http://www.aboutlawsuits.com/contact-lens-lenovo-wine-mdls-83097/>.

<sup>136</sup> *Machikawa v. Cooper Vision, Inc., et al.*, Case No. 3:15-cv-1001 (N.D. Col) (2015).

<sup>137</sup> Sherman Act, 15 U.S.C. §1.

<sup>138</sup> *Serge Pentsak et al. v. CooperVision Inc. et al* Case Number 4:15-cv-01097, (2015).

<sup>139</sup> *Serge Pentsak et al. v. CooperVision Inc. et al* (2015).

## Implications for the Current Debate

An important question in the current debate is what impact the long history of inter-channel conflict in the sale of contact lenses will make on assessments of the pricing practices of contact lens manufacturers. Those complaining of these pricing practices contend they are an extension of past inter-channel conflicts between traditional (e.g., ECP) and alternative channels of distribution to newer retail formats that, because of their innovation, are able to offer lower prices.<sup>140</sup> Innovation is a significant goal of antitrust and retail innovation is an increasingly important form of innovation. Consequently, significant questions concern the history of inter-channel conflict and its significance for understanding the impact of manufacturers pricing practices on retail innovation involving the retail distribution of contact lenses.

**Significance of Innovation to antitrust.** A widely accepted goal of antitrust is innovation or what economists refer to as dynamic efficiency.<sup>141</sup> The concept of dynamic efficiency involves the growth of an economic system over time.<sup>142</sup> Dynamic efficiency can be contrasted with static efficiency which refers to the efficiency of a system at a point in time.<sup>143</sup> Applied to antitrust, dynamic efficiency is concerned with the extent to which a defined system (i.e., a market) develops and progresses over time.<sup>144</sup> Firms are understood to contribute to dynamic efficiency through improvements in their offerings and through improvements in their processes.<sup>145</sup> Such improvements can include those relating to distribution. However, some uncertainty surrounds the necessary conditions for technological progress and the optimal amount and the rate of advancement through innovation for a given economic system or firm is not well understood.<sup>146</sup> For some systems, dynamic efficiency is understood to be more

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<sup>140</sup> Atkinson (2014), 1 (“One industry that has had a long practice of employing such barriers to limit consumer choice is optometry. Optometrists have lobbied for anti-competitive state laws and engaged in anti-competitive behavior in order to restrict their customers from buying contact lens from other channels, including online and —big boxl retailers. They are at it once again, now by encouraging contact lens producers to use resale price maintenance policies – in this case called unilateral pricing policy (UPP).”).

<sup>141</sup> LAWRENCE SULLIVAN & WARREN GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* 16 (2006) (“Another widely accepted goal of antitrust policy is to promote innovation, or what the economist refer to as the dynamic efficiency of the economy.”).

<sup>142</sup> Andrew B. Abel, N. Gregory Mankiw, Lawrence H. Summers & Richard J. Zeckhauser, *Assessing Dynamic Efficiency: Theory and Evidence*, 56 *REVIEW OF ECONOMIC STUDIES* 1 (1989) (describing the term “dynamic efficiency” in relation to economic systems).

<sup>143</sup> Various types of economic efficiency are common to discussions of efficiency in antitrust. This includes “static” efficiency which refers to whether, in the short run, resources are allocated optimally, and “dynamic” efficiency which focuses on longer-term reductions in cost and improvements in quality. Gregory T. Gundlach & Diana Moss, *The Role of Efficiencies in Antitrust Law: Introduction and Overview*, 60 *ANTITRUST BULLETIN* 91-102 (2015).

<sup>144</sup> Various types of economic efficiency are common to discussions of efficiency in antitrust. This includes “static” efficiency which refers to whether, in the short run, resources are allocated optimally, and “dynamic” efficiency which focuses on longer-term reductions in cost and improvements in quality. Gundlach & Moss (2015), 91-102.

<sup>145</sup> BEN VAN ROMPUY, *ECONOMIC EFFICIENCY: THE SOLE CONCERN OF MODERN ANTITRUST POLICY?* 29 (2012) (“Dynamic efficiency refers to the extent to which a firm develops and diffuses new products or production processes.”). Philip Nelson & David Smith, *Efficiencies in Antitrust Analysis: A View from the Middle of the Road*, 60 *ANTITRUST BULLETIN* 128 (2015) (Describing improvements in productive efficiency that over time improve dynamic efficiency: “These improvements may be reflected in lower production costs for producing a given output (“process efficiencies”) or in the ability to produce higher quality products (“product innovation.”)).

<sup>146</sup> Van Rompuy, 29 (2012) (“The uncertainty inherent in innovative activity, however, makes it difficult to establish what the optimal amount and rate of technological progress should be.”). Melissa A. Schilling, *Towards Dynamic Efficiency: Innovation and Its Implications for Antitrust*, 60 *ANTITRUST BULLETIN* 191 (2015) (“However, determining how to incorporate innovation into efficiency goals is complicated; innovation typically entails great

important for advancing economic welfare than one-time static efficiencies.<sup>147</sup> This is particularly true for systems where innovation is a key competitive consideration<sup>148</sup> and systems that are subject to ongoing change.<sup>149</sup> As recognized by the Antitrust Modernization Committee in 2007: “Innovation provides a significant share of the consumer benefits associated with competition, particularly in the most dynamic industries.”<sup>150</sup>

**Importance of distribution-related innovation.** Advances in distribution represent an important form of dynamic efficiency. Innovative formats of retail distribution can result in lower prices through reducing the cost of distribution. Historical examples of retail innovation include catalog showrooms, big-box (i.e., discount) retailers, wholesale clubs and most recently Internet retailers. E-commerce has been identified as one form of retail innovation likely to cause “dramatic changes in the business environment” and to “influence various aspects of marketing channels structure and strategy.”<sup>151</sup> E-commerce is transforming channel systems worldwide and in most industries.<sup>152</sup> As summarized in a leading textbook on marketing channels:

“The technology, logistics and market reach capabilities of the online channel allow suppliers to sell directly to customers, often without intermediary channel participation. The Internet enables startups and new firms to sell directly to customers, undermining the power of channel intermediaries; it also diminishes the geographic, temporal and informational constraints that were fundamental to the design of existing channel systems.”<sup>153</sup>

Given these effects, the move to e-commerce distribution over time has been intense and accelerating.<sup>154</sup> In 2012, e-commerce sales exceeded \$1 trillion and were predicted to reach \$1.3 trillion in 2013. The United States represents the largest market for online sales with \$343 billion in sales, followed by China, the United Kingdom, Japan, and Germany.<sup>155</sup> According to one survey of CEOs, 90 percent state that they plan to increase their use of e-commerce channels and a majority of these CEOs state that e-commerce is their single biggest growth driver.<sup>156</sup>

**Relevance of inter-channel conflict involving contact lens distribution.** Given the significance of innovation to antitrust and the increasing importance of distribution-related

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uncertainty, long time horizons, and interdependencies across projects. This means there are no easy solutions for estimating the welfare impact of any given innovation investment or strategy.”). Nelson & Smith (2015).

<sup>147</sup> F.M SCHERER & D. ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE (1990). Nelson and Smith, (2015) (“While one-time static efficiencies may have important effects on consumer welfare, dynamic efficiencies can be even more important.”).

<sup>148</sup> John Kwoka, *The Changing Nature of Efficiencies in Mergers and in Merger Analysis*, 60 ANTITRUST BULLETIN 231 (2015) (“In industries where innovation is the key competitive variable—industries such as pharmaceuticals, software, and search—dynamic considerations take on equal or greater importance as static cost and price issues.”).

<sup>149</sup> Deborah A. Garza, Antitrust Modernization Commission, et al, *Antitrust Modernization Committee: Report and Recommendations* 39 (2007), [http://govinfo.library.unt.edu/amc/report\\_recommendation/amc\\_final\\_report.pdf](http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf).

<sup>150</sup> Garza (2007), 39.

<sup>151</sup> ROBERT W. PALMATIER, LOUIS W. STERN & ADEL I. EL-ANSARY, MARKETING CHANNEL STRATEGY 264 (2015).

<sup>152</sup> Palmateir, Stern & El-Ansary (2015), 265.

<sup>153</sup> Palmateir, Stern & El-Ansary (2015), 279.

<sup>154</sup> Palmateir, Stern & El-Ansary (2015), 279.

<sup>155</sup> Don Reisinger, Cnet.com, *E-commerce Spending Hits \$1 Trillion for First Time* (2013), <http://www.cnet.com/news/e-commerce-spending-hits-1-trillion-for-first-time>.

<sup>156</sup> Jessica Liddell, Businesswire.com, *Retail CEOs Turn to Global and Digital Expansion* (2011), <http://www.businesswire.com/news/home/20111114005904/en/Retail-CEOs-Turn-Global-Digital-Expansion-Strategies>.

innovation, the history of inter-channel conflict in the contact lenses industry yields important instruction for understanding the current debate. A focus of inquiry in this debate will be the effects of manufacturers' pricing practices on competition including their effect on innovation that benefits consumers in the form of lower prices. As discussed subsequently, a widely recognized harm of restrictive pricing practices is its effect of slowing down the pace of retail innovation from lower cost (i.e., more efficient) forms of retailing that can offer lower prices to consumers. A recurrent theme in the past conflicts found in the contact lens industry is that, in an effort to protect their profits, contact lens manufacturers and incumbent ECPs have engaged in repeated efforts to eliminate competition from new forms of retail distribution for contact lens. This was alleged to have occurred in the past with pharmacies and mail-order retailers and is now alleged to be the case with wholesale clubs, discount retailers, and Internet retailers. Although employing methods in addition to restrictive pricing practices, the prior conflicts provide a historical context that is consistent with the current allegations. Taken together, these prior conflicts and the current allegations also evidence a pattern of ongoing conduct.

### Directions for Analysis

Analyses that bear in mind the aforementioned insights should be helpful to ongoing assessments of the competitive implications of contact lens manufacturers' pricing practices. To extent these analyses are able to further document the history of inter-channel conflict involving manufacturers and ECPs on the one side, and alternative forms of retail distribution on the other, they should offer useful information for understanding the motivations for these pricing practices. Future analyses should more particularly identify and compare the motivations that characterized these prior conflicts and the current debate. These analyses should also investigate whether the differences that distinguished the efficiency (i.e., costs and prices) and effectiveness (i.e., convenience and service) of different retail channels for contact lenses found in the past by the FTC continue today. More generally, future analyses should look for similarities (and differences) between the past conflicts and the current debate.

## STANDARD OF AGREEMENT

Prior to *Leegin*, under the *per se* rule, the harmful effects of RPM were inferred from the presence of an agreement between a manufacturer and its retailers to limit the price at which the manufacturer's products could be resold. Thus, proof on an agreement was dispositive for finding RPM that unreasonably restrained trade. Overtime though, legal doctrine protecting a manufacturer's right to deal with whomever it wanted (i.e., the *Colgate* Doctrine) and academic skepticism of the *per se* rule against RPM, led to an increasingly strict judicial standard for finding the requisite agreement necessary to find RPM. Given post-*Leegin* RPM will be judged following the rule of reason, antitrust scholars have increasingly questioned whether this strict standard of agreement continues to be necessary or even desirable. Under the rule of reason, emphasis is given to the competitive effects of a practice rather than the form of agreement. Consequently, important questions in the current debate concern the standard of agreement that will be applied for assessing the antitrust consequences of contact lens manufacturers' pricing practices.



## Necessity of a Strict Standard of Agreement

**Pre-*Leegin*.** The strict standard of agreement for judicial treatment of RPM following the *per se* rule is traceable to various Supreme Court decisions. See Table 2. The first involved *United States v. Colgate & Co.* where the Court reaffirmed “the long recognized right of a trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal; and, of course, he may announce in advance the circumstances under which he will refuse to sell.”<sup>157</sup> The Colgate decision was then clarified in *Monsanto Co. v. Spray-Rite Serv. Corp.* where the Court held that, “under Colgate, the manufacturer can announce its resale prices in advance and refuse to deal with those who fail to comply, and a distributor is free to acquiesce to the manufacturer's demand in order to avoid termination.”<sup>158</sup> The Court went on to require that for an agreement to exist “there must be evidence that tends to exclude the possibility of independent action ... That is, there must be direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others had a conscious commitment to a common scheme designed to achieve an unlawful objective.”<sup>159</sup> Subsequently, in *Business Electronics Corp. v. Sharp Electronics Corp.* (1988) the Court found further that “[t]here has been no showing here that an agreement between a manufacturer and a dealer to terminate a ‘price cutter,’ without a further agreement on the price or price levels to be charged by the remaining dealers, almost always tends to restrict competition and reduce output.”<sup>160</sup>

***Emergence of unilateral price policies.*** In association with the strict standard established by the Supreme Court for finding an agreement, so-called “Colgate policies” emerged and permitted manufacturers to limit the resale prices for their products without being found to have entered an agreement. Given the unilateral nature of such policies, they became known as “unilateral price policies.” Aside from manufacturer suggested resale prices (i.e., MSRP) and having resellers act as an agent of the manufacturer and sell goods on consignment, until *Leegin*, UPPs were adopted by manufacturers to directly influence reseller’s prices without the prospect of subjecting themselves to *per se* liability. *Leegin* abrogated the *per se* rule against RPM and replaced it with the rule of reason providing manufacturers more leeway in their pricing practices. However, the decision also shifted the focus of antitrust inquiries from finding an agreement to whether a manufacturer’s pricing practice has the effect of unreasonably restraining trade.

**Post-*Leegin*.** Following *Leegin*, proof of an agreement continues to be a part of relevant statutes and the Courts dissenting opinion in *Leegin* assumed that Colgate would remain “good law.”<sup>161</sup> However, since the decision, legal scholars and commentators have argued that the, “the continuing importance of *Monsanto* and *Business Electronics* is not clear”<sup>162</sup> with some

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<sup>157</sup> *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919).

<sup>158</sup> *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984).

<sup>159</sup> *Monsanto Co.* (1984), 768.

<sup>160</sup> *Business Electronics Corp. v. Sharp Electronics Corp.* 485 U.S. 717 727-28 (1988).

<sup>161</sup> *Leegin* (2007), 924. Areeda & Hovenkamp (2009), A-27 (commenting on the “little guidance” offered by the Supreme Court in *Leegin* regarding “how much of those decisions remain good law. One such example is *Business Electronics*, which applied the *per se* RPM rule only if there was a specific agreement on ‘price or price levels.’”).

<sup>162</sup> E. THOMAS SULLIVAN & JEFFERY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS (2009).

concluding that post-*Leegin*, “the impact of both *Colgate* and *Monsanto* is significantly reduced by *Leegin*.”<sup>163</sup> As concluded by some, the past [h]ypertechnical requirements seemed more designed to frustrate enforcement under an overly aggressive [per se] rule than to expose the anticompetitive possibilities of RPM. Consequently, according to Hovenkamp, “[u]nder the rule of reason such strictness is no longer necessary because anticompetitive effects are no longer inferred from the price agreement alone.”<sup>164</sup> Instead, the rule of reason asks only whether a practice unreasonably restrains trade<sup>165</sup> and the use of RPM can readily do that “even if there is not specific agreement on price or price levels.”<sup>166</sup> Hence, “more allowance on the agreement issues seems appropriate under the *Leegin* rule of reason.”<sup>167</sup> The views of legal scholars and commentators that question the relevance of unilateral price policies have found support among advocacy groups such as the AAI which has publically asserted, “But now that RPM is no longer *per se* illegal, there is every reason to narrowly construe the *Colgate* doctrine.”<sup>168</sup>

***Distinction of unilateral price policies.*** Consistent with arguments against a strict standard of agreement, as *Leegin* was being decided, scholars predicted that “*Colgate*’s fiction of no agreement ... might well be abandoned if *Dr. Miles* is ever overruled.”<sup>169</sup> As explained by one commentator, in analytic terms “...*Leegin* tends to blur the distinction between RPM agreements and *Colgate* UPPs by subjecting both to nominally the same analysis, undermining the foundational *Colgate* argument that a trader may choose with whom it will deal.”<sup>170</sup> Thus, “the distinction between unilateral policies and agreements is of less importance” following *Leegin*.<sup>171</sup> The Court itself noted in *Leegin* that “[t]he economic effects of unilateral and concerted price setting are in general the same.”<sup>172</sup> Moreover, commentators have observed that “...repealing *Dr. Miles* will permit courts to focus on economic substance rather than *Colgate*’s artificial and formalistic distinctions.”<sup>173</sup>

### **Desirability of a Strict Standard of Agreement**

Beyond legal and economic considerations that question the necessity of a strict standard of agreement following *Leegin*, due to management challenges associated with unilateral price policies, a strict standard of agreement may also not be desirable. As a pricing strategy, unilateral price policies are challenging to develop and adopt and costly to monitor and enforce.

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<sup>163</sup> Herbert J. Hovenkamp, *Leegin, the Rule of Reason, and Vertical Agreement*, Iowa Legal Studies Research Paper No. 10-40, 13 (2010), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1673519](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1673519). Areeda & Hovenkamp (2009), A-27 (“The implications for *Monsanto* and the *Colgate* doctrine are less clear”).

<sup>164</sup> Hovenkamp (2010), 7.

<sup>165</sup> Areeda & Hovenkamp (2009), A-27.

<sup>166</sup> Areeda & Hovenkamp (2009), A-27 (Describing that in the absence of agreement on price and price levels the use of RPM may result in higher prices from reduced output: “A powerful dealer’s insistence that a manufacturer impose higher resale prices on rival dealers can readily do that, even if there is no specific agreement on price and price levels.”)

<sup>167</sup> Hovenkamp (2010), 8.

<sup>168</sup> Foer (2014), 2.

<sup>169</sup> ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS, AND PROBLEMS IN COMPETITION POLICY 363 (2003).

<sup>170</sup> Horvath (2015).

<sup>171</sup> Frank M. Hinman & Sujal J. Shah, *Counseling Clients on Vertical Price Restraints*, 23 ANTITRUST 60 (2009).

<sup>172</sup> *Leegin* (2007), 644.

<sup>173</sup> Richard M. Brunell, *Overruling Dr. Miles: the Supreme Trade Commission in Action*, 52 ANTITRUST BULLETIN 475 (2007).

Consequently, these features result in practical questions as to whether a strict standard of agreement is desirable following *Leegin*.

**Design and adoption issues.** Unilateral price policies are challenging to develop and adopt. As recognized by the Court in *Leegin*, developing unilateral policies that comply with the “stringent standards in *Monsanto* and *Business Electronics*, ... can lead, and has led, rational manufacturers to take wasteful measures.”<sup>174</sup> Echoing the Court’s views, Brunell observes that the strict standard “only pushes manufacturers that wish to set retail prices to adopt wasteful or seemingly irrational measures to get into the former [UPP] category.”<sup>175</sup> A manufacturer might, for example, refuse to discuss its pricing policy with its distributors except through counsel knowledgeable of the subtle intricacies of the law or terminate a longstanding distributor for a minor violation without seeking an explanation.<sup>176</sup>

**Monitoring and enforcement costs.** Unilateral price policies are also costly to monitor and enforce. According to Hinman, “because of the need to walk the Colgate line, monitoring and enforcing a unilateral policy can impose significant legal costs on a manufacturer.”<sup>177</sup> Under Colgate, manufacturers have few choices with respect to violators. The manufacturer can ignore the violation which can undercut the policy’s effectiveness and lead to more violations within the retail system or terminate the offending retailer which can lead to a suboptimal outcome for everyone including consumers.<sup>178</sup> In this regard, the Court in *Leegin*, concluded that “[t]he increased costs these burdensome measures generate flow to consumers in the form of higher prices.”<sup>179</sup>

A consequence of the management challenges associated with UPPs is that they are “typically harder to control and less efficient”<sup>180</sup> when compared to conventional arrangements. Thus, the use of UPPs has “resulted in much nail biting on the part of supplier executives.”<sup>181</sup> Apart from antitrust risks and the business considerations associated with managing and enforcing UPPs, franchise, distributor, dealer-protection laws or other industry specific laws may also affect and complicate the management and enforcement of UPPs.<sup>182</sup> Thus, as concluded by at least one observer, “...it seems evident that many companies find Colgate policies too draconian and costly a weapon to use to combat discounting.” Notably in this regard, foreign jurisdictions do not allow manufacturers to get around RPM prohibitions by adopting UPP policies.<sup>183</sup>

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<sup>174</sup> *Leegin* (2007), 645 (citing Brief for PING, Inc., as Amicus Curiae 9-18).

<sup>175</sup> Brunell (2007), 523.

<sup>176</sup> *Leegin* (2007), 645.

<sup>177</sup> Hinman (2009).

<sup>178</sup> Hinman (2009) (“Maintaining a strictly unilateral policy in the face of a violation requires either ignoring it — which can undercut the policy’s effectiveness and even lead to a snowball effect within the dealer network — or terminating the offending dealer, which might be a sub-optimal outcome for everyone, including consumers.”).

<sup>179</sup> *Leegin* (2007), 645.

<sup>180</sup> Hinman (2009) (“Unilateral policies, while designed to avoid the reach of Section 1, are typically harder to control and less efficient.”).

<sup>181</sup> Brian R. Henry & Eugene E. Zelek, Jr., *Establishing and Maintaining an Effective Minimum Resale Price Policy: A Colgate How-To*, 8 ANTITRUST 1 (2003).

<sup>182</sup> Henry (2003), 11. Brunell (2007), 523 (citing Henry & Zeleck “Beyond the antitrust risks and the business considerations of having to terminate good customers, the authors point out that franchise, distributor, dealer-protection laws or other industry specific laws may affect the ability of the supplier to refuse to supply a reseller.”).

<sup>183</sup> Brunell (2007), 526 (citing Europe and Canada).



## Relevant Trends in Distribution Channel Relationships

Existing trends in the practice of distribution channel management are likely to also impact the necessity and desirability of UPP arrangements going forward. Three trends are particularly relevant. These include the movement toward more relational forms of interaction between manufacturers and retailers, the increasing complexity of these exchanges, and the growing power of some resellers relative to manufacturers. A growing literature in marketing and related disciplines demonstrates a trend in distribution channel management away from simple arm's length transactions to more complex and relational forms of interaction and exchange.<sup>184</sup> According to this literature, rather than narrow, one-way exchanges dominated by a manufacturer; contemporary relations between manufacturers and retailers have come to involve increasingly multifaceted, two-way exchanges often dominated by retailers.<sup>185</sup> An implication of this trend is that while the nature of past channel exchanges lent themselves to the development and implementation of unilateral price policies, contemporary relations between manufacturers and retailers are much less supportive, and potentially at odds, with such policies. To the extent this trend has impacted a particular channel, it is likely to affect the ability of manufacturers to efficiently and effectively develop and implement unilateral price policies. Coupled with the standard shifting impact of *Leegin*, it is also likely to increase the probability that an agreement will be found where such policies are used.

As previously described, existing legal doctrine relevant to RPM indicates a distinction between arrangements that involve simple, one-way dealings by a manufacturer with its retailers and agreements involving more complex, two-way interactions between manufacturers and retailers. Thus, arrangements involving a unilateral price policy, where a manufacturer merely announces its resale prices in advance and refuses to deal with retailers who fail to comply, is not considered an agreement, even though retailers may acquiesce to a manufacturer's demands in order to avoid termination. The simple and one-way nature of the arrangement distinguishes such arrangements from an agreement. In contrast, where a manufacturer engages in more complex, two-way interactions with retailers to gain their compliance (e.g., negotiates with them, meets with them, engages in repeated exhortations, or uses third parties), the requisite form of agreement is generally found.

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<sup>184</sup> Johan Arndt, *Toward a Concept of Domesticated Markets*, 43 JOURNAL OF MARKETING 69 (1979) ("To an increasing degree, transactions are occurring in "internal" markets within the framework of long-term relationships, not on an ad hoc basis"). Frederick E. Webster, *The Changing Role of Marketing in the Corporation*, 56 JOURNAL OF MARKETING 1 (1992) (There has been "a clear evolution away from arm's length transactions and traditional, hierarchical and bureaucratic forms of organization"). Daniel Corsten & Nirmalya Kumar, *Do Suppliers Benefit from Collaborative Relationships with Large Retailers? An Empirical Investigation of Efficient Consumer Response Adoption*, 69 JOURNAL OF MARKETING 80 (2005) ("Over the past two decades, marketing theory and practice has embraced the idea of relationship marketing").

<sup>185</sup> Jiun-Sheng Chris Lin & Yun-Chi Chang, *Retailers' new product acceptance decisions: incorporating the buyer-supplier relationship perspective*, 27 JOURNAL OF BUSINESS & INDUSTRIAL MARKETING 2 89 (2012) ("Because the risk associated with offering new products is relevant to both the supplier and the retailer, it is likely that both would be motivated to create closer relationships. Many firms have responded to these challenges by forming collaborative relationships with their retail customers."). Hans B. Thorelli, *Networks: Between Markets and Hierarchies*, 7 STRATEGIC MANAGEMENT JOURNAL 37 (1986) ("As power, influence and trust constitute such important aspects of buyer-seller relationships it is also clear that we have been missing a holistic view of such relationships.").

**Past channel exchange.** In historical terms past relations between manufacturers and resellers readily lent themselves to the use of unilateral price policies.<sup>186</sup> In these exchanges, manufacturers and retailers acted as independent entities.<sup>187</sup> Dealings among them were conducted at arm's length with activities governed by market forces.<sup>188</sup> Manufacturers dominated these interactions given the lack of economic organization among retailers.<sup>189</sup> Channel management in these market-based relationships consisted of manufacturers developing and implementing self-centered, power-based approaches for unilaterally influencing retailers.<sup>190</sup> The emphasis focused on controlling resellers in furtherance of the manufacturer's goals.<sup>191</sup> For their part, retailers were limited to complying with a manufacturer request or being replaced by another retailer.<sup>192</sup> The simple, one-way, nature of these exchanges supported the development and implementation of unilateral price policies. Acting independently and at arm's length, a more powerful manufacturer could announce resale prices and then steadfastly refuse to deal with retailers who failed to comply with their unilateral directives.<sup>193</sup> In response, less powerful retailer's acting independently were relegated to complying with the manufacturer's demands or be terminated.<sup>194</sup>

**Contemporary channel relations.** Today, relations between manufacturers and resellers differ markedly from the past, rendering many of them much less supportive, and potentially at odds, with the use of unilateral price policies. As documented in the marketing literature and

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<sup>186</sup> Louis P. Bucklin, *A Theory of Channel Control*, 37 JOURNAL OF MARKETING 39 (1973) ("Historically, manufacturers have sought to limit competition among their middlemen through agreements on resale price...").

<sup>187</sup> Luis Araujo, Anna Dubois & Lars-Erik Gadde, *Managing Interfaces with Suppliers*, 28 INDUSTRIAL MARKETING MANAGEMENT 497 (1999) ("There are no relevant technical or organizational interdependencies between the two parties and the two organizations only require a simple sales-to-purchasing functional interface to conduct exchanges.").

<sup>188</sup> Jeffrey H. Dyer, Dong Sung Cho & Wujin Chu, *Strategic Supplier Segmentation: The Next "Best Practice" in Supply Chain Management*, 40 CALIFORNIA MANAGEMENT REVIEW 57 (1998) ("The traditional view, or the *arm's-length model* of supplier management, advocates minimizing dependence on suppliers and maximizing bargaining power... The key implication of this model for purchasing strategy is for buyers to deliberately keep suppliers at "arm's-length" and to avoid any form of commitment. The arm's-length model was widely accepted as the most effective way to manage supplier relationships in the United States...").

<sup>189</sup> Michaela Draganska, Daniel Klapper & Sofia B. Villas-Boas, *A Larger Slice or a Larger Pie? An Empirical Investigation of Bargaining Power in the Distribution Channel*, 29 MARKETING SCIENCE 57 (2010) ("There has been a great deal of discussion about the purported power shift from manufacturers to retailers due to the consolidation of the retail sector...").

<sup>190</sup> Anthony J. Dukes, Tansev Geylani & Kannan Srinivasan, *Strategic Assortment Reduction by a Dominant Retailer*, 28 MARKETING SCIENCE 309 (2009) ("Traditionally, it was the manufacturer who defined the breadth of its product line and distributed all varieties through complying retailers.").

<sup>191</sup> Jae-eun Chung, Buounggho Jin & Brenda Sternquist, *The Role of Market Orientation in Channel Relationships When Channel Power is Imbalanced*, 17 THE INTERNATIONAL REVIEW OF RETAIL, DISTRIBUTION AND CONSUMER RESEARCH 2 159 (2007) ("As retailer dependence on a particular supplier increases, that supplier becomes more important for the retailer, which encourages the supplier to exercise influence over the retailer.").

<sup>192</sup> Sandra Hogarth-Scott, *Retailer-Supplier Partnerships: Hostages to Fortune or the Way Forward for the Millennium?*, 101 BRITISH FOOD JOURNAL 668 (1999) ("The manufacturer dictated much of the marketing mix and, to some extent, the retailer's role was that of a conduit for the manufacturer's brands.").

<sup>193</sup> Surinder Tikoo & Bruce Mather, *The Changed Legality of Resale Price Maintenance and Pricing Implications*, 54 BUSINESS HORIZONS 415 (2011) ("...the manufacturer unilaterally determined to deal with retailers which did not comply with an announced RPM policy...").

<sup>194</sup> Jeffrey L. Harrison, *Dr. Miles's Orphans: Vertical Conspiracy and Consignment in the Wake of Leegin*, 45 WAKE FOREST L. REV 1125 (2010) ("... a manufacturer can announce a resale price and refuse to deal or terminate a reseller that does not adhere to that price.").

related fields, channel members have become increasingly interdependent of one another.<sup>195</sup> Dealings among them have evolved to become not only more collaborative and cooperative,<sup>196</sup> but also more complex and involved.<sup>197</sup> In many cases, market governance has been supplanted or complemented by other mechanisms of governance<sup>198</sup> and affected by the “shadow” of a longer-term view.<sup>199</sup> Retailers now dominate many of these interactions,<sup>200</sup> but growing upstream and downstream concentration marks many relations.<sup>201</sup> Although channel management continues to incorporate power-based approaches,<sup>202</sup> given changes to existing power structures, in many relations, increasing emphasis is being given to the establishment, development, and maintenance of ongoing and mutually beneficial relationships between manufacturers and retailers.<sup>203</sup> In these relations, rather than being relegated to a compliant recipient of unilateral directives, many retailers have become active participants in the development and implementation of channel initiatives and policies, if not the source of them.<sup>204</sup> Consequently, the complex, two-way, nature of contemporary relations between manufacturers

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<sup>195</sup> Irina V. Kozlenkova, Thomas M. Hult, Donald J. Lund, Jeannette A. Mena & Pinar Kecec, *The Role of Marketing Channels in Supply Chain Management*, 91 JOURNAL OF RETAILING 586 (2015) (“For the past decade, the surge in interest in SCM can be attributed to: ... (2) the trend toward time-and quality-based competition, which requires a closer relationship and coordination between the firm and its suppliers.”).

<sup>196</sup> Corsten & Kumar (2005), 80 (“Besides the resultant price pressure from large retailers, suppliers are finding it increasingly difficult to develop their marketing strategy in isolation of the particular retailer’s strategy. This has encouraged suppliers to develop closer relationships with major retailers...”).

<sup>197</sup> Martin K. Hingley, Adam Lindgreen & Brett Casswell, *Buyer-Supplier Relationships in the UK Fresh Produce Industry*, 102 BRITISH FOOD JOURNAL 6 (2000) (“It is also evident from this research that both retailers and suppliers are working, not with the concept of a single relationship, but are managing sets of relationships as portfolios.”).

<sup>198</sup> Joseph P. Cannon, Ravi S. Achrol & Gregory T. Gundlach, *Contracts, Norms, and Plural Form Governance*, 28 JOURNAL OF THE ACADEMY OF MARKETING SCIENCE 180 (2000) (“Different control mechanisms serve as building blocks for complex structures of governance that combine elements of markets, hierarchies, and relational exchange in complementary, supplementary, or alternative ways.”).

<sup>199</sup> Jan B. Heide & Anne S. Miner, *The Shadow of the Future: Effects of Anticipated Interaction and Frequency of Contact on Buyer-Seller Cooperation*, 35 THE ACADEMY OF MANAGEMENT JOURNAL 265 (1992) (“The success of reciprocity strategies, however, usually depends on sufficient value being placed on future returns, or on a sufficiently long “shadow of the future”...”).

<sup>200</sup> Zhimin Huang & Susan X. Li, *Co-op Advertising Models in Manufacturer-Retailer Supply Chains: A Game Theory Approach*, 135 EUROPEAN JOURNAL OF OPERATIONAL RESEARCH 527 (2001) (“The shift of power from manufacturers to retailers is one of the most significant phenomena in manufacturing and retailing.”). Ravi S. Achrol & Phillip Kotler, *Marketing in the Network Economy*, 62 JOURNAL OF MARKETING 146 (1999) (“The most radical implication for marketing is the shift from being an agent of the seller to being an agent of the buyer...”).

<sup>201</sup> Vrinda Kadiyali, Pradeep Chintagunta & Naufel Vilcassim, *Manufacturer-Retailer Channel Interactions and Implications for Channel Power: An Empirical Investigation of Pricing in a Local Market*, 19 MARKETING SCIENCE 127 (2000) (“Other reasons for retailer power include increased concentration at the retail level...”).

<sup>202</sup> Andrew Cox, *Power, Value and Supply Chain Management*, 4 SUPPLY CHAIN MANAGEMENT: AN INTERNATIONAL JOURNAL 167 (1999) (“There are clearly a variety of power configurations within different types of supply chains, and these configurations occur for a variety of reasons.”).

<sup>203</sup> Shankar Ganesan, *Determinants of Long-Term Orientation in Buyer-Seller Relationships*, 58 JOURNAL OF MARKETING 1 (1994) (“... mutual commitment results in independent channel members working together to serve customer needs better and increase mutual profitability.”). Corsten & Kumar (2005), 80 (“Besides the resultant price pressure from large retailers, suppliers are finding it increasingly difficult to develop their marketing strategy in isolation of the particular retailer’s strategy. This has encouraged suppliers to develop closer relationships with major retailers...”).

<sup>204</sup> Achrol (1999), 146 (“The most radical implication for marketing is the shift from being an agent of the seller to being an agent of the buyer...”). Zhimin (2001), 527 (“The shift of power from manufacturers to retailers is one of the most significant phenomena in manufacturing and retailing”).

and retailers has rendered them much less compatible, if not at odds with, the development and implementation of unilateral price policies and existing legal doctrine.

### Theories of Agreement Post-*Leegin*

In the wake of *Leegin*, some antitrust scholars have proposed different theories to explain, for purposes of finding the requisite agreement, how antitrust scrutiny may be triggered in cases involving allegations of RPM. These theories reason that a retailer's compliance with a manufacturer's announced conditions for dealing (including unilateral price policies), may be presumed as equivalent in effect to express agreements. Professor Herbert Hovenkamp, for example, proposes two theories for finding "extended" agreements in such instances – implied acceptance and coerced compliance.<sup>205</sup>

**Implied acceptance.** An implied acceptance is one "that is not directly stated but is demonstrated by any acts indicating a person's assent to the proposed bargain."<sup>206</sup> Such acts include those that make evident that a party has agreed indirectly to the terms of an arrangement. Extended to circumstances involving RPM, a theory of implied acceptance reasons that a retailer's compliance with a unilateral price policy amounts to an agreement.<sup>207</sup>

**Coerced compliance.** Coercion occurs "when an individual is compelled to act against their will."<sup>208</sup> Coercion can result from psychological, physical, economic, financial, and other pressures. Applied to RPM, a theory of coerced compliance reasons that a retailer's compliance with a unilateral price policy effectively surrenders the retailer's will and thereby amounts to an agreement.<sup>209</sup>

Hovenkamp contends that such theories are consistent with existing doctrine and the results of *Monsanto*. Under both theories, a requisite agreement is found when (1) there is an announced condition or its equivalent on future dealing, (2) the sanction for noncompliance is credible, and (3) the market effects of the arrangement are proven or presumed to be similar to those of express agreements. Together with the implications of *Leegin*, theories of implied acceptance and coerced agreement raise significant questions as to whether, going forward, unilateral price policies that meet these standards should not be found to involve the requisite judicial standard of agreement for rule of reason inquiries involving RPM.

### Implications for the Current Debate

Given the *Leegin* decision, subsequent legal scholarship involving the necessity and desirability of a strict standard agreement, relevant trends in distribution management, and proposed theories of agreement for finding RPM, an important question in the current debate involves what standard of agreement will be applied to assessments of the pricing practices of contact lens manufacturers. Those complaining of these pricing practices argue that resellers have entered into agreements with manufacturers to abide by their pricing practices. However, manufacturers contend their pricing practices involve a "unilateral price policy" and thus do not

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<sup>205</sup> Hovenkamp (2010), 8.

<sup>206</sup> TheFreeDictionary.com, implied acceptance (2015), <http://legal-dictionary.thefreedictionary.com/implied+acceptance>.

<sup>207</sup> Hovenkamp (2010), 8.

<sup>208</sup> TheFreeDictionary.com, coercion (2015), <http://legal-dictionary.thefreedictionary.com/coercion>.

<sup>209</sup> Hovenkamp (2010), 8.

encompass an agreement with resellers. Consequently, an important area of inquiry will concern this standard and its application to the pricing practices of contact lens manufacturers.

**Standard of agreement.** As described above, following *Leegin*, proof of an agreement continues to be a part of relevant statutes and the Courts dissenting opinion in *Leegin* assumed that Colgate would remain “good law.”<sup>210</sup> However, scholars contend that a strict standard of agreement is no longer relevant given that anticompetitive effects are no longer inferred from a price agreement and the rule of reason emphasizes the effects of a practice. These scholars further argue that a strict standard of agreement may not be desirable due to the costs and inefficiencies associated with UPPs that comply with the Colgate doctrine. In the wake of *Leegin* and these arguments, antitrust scholars have proposed different theories to explain, for purposes of finding the requisite agreement, how antitrust scrutiny may be triggered in cases involving allegations of RPM. There is also evidence that existing trends in the practice of distribution channel management have created an environment that is less supportive, and potentially at odds, with the use of unilateral price policies. Together, these arguments, theories and trends yield questions as to what standard of agreement will be applied to the pricing practices of contact lens manufacturers. In this regard, summarizing this state of affairs as it relates to current state legislation involving these pricing practices, one commentator has concluded that:

“There have always been problems with Colgate policies, the main one being that supplier-dealer communications surrounding them have tended to turn them into de facto agreements challengeable as RPM. But where manufacturers may have happily imagined a post-*Leegin* world in which bilateral RPM agreements were difficult to challenge while unilateral Colgate policies remained almost per se lawful, cases like the contact lens situation could convince lawmakers that the unilateral nature of UPP is a trivial distinction, and fair game for legislation.”<sup>211</sup>

**Contact lens manufacturers’ pricing arrangements.** Lawsuits filed against contact lens manufacturers contain allegations of extensive communication between manufacturers and retailers regarding manufacturer pricing practices. In Costco’s lawsuit these allegations include that Johnson & Johnson continuously “negotiated”<sup>212</sup> and “revised”<sup>213</sup> their policy after input from ECPs.<sup>214</sup> The lawsuit also alleges that Johnson & Johnson promised to “brainstorm” with Costco on early versions of their pricing policy and find some “middle ground” and some “common ground”<sup>215</sup> in order to find an “acceptable solution.” Further, the lawsuit alleges that Johnson & Johnson “modified” and created “exceptions” to their policies in response as a result of their interactions with Costco.<sup>216</sup> Costco alleges these types of interactions occurred with other retailers and resulted in no less than five (5) revisions to Johnson & Johnson’s policies. In the Marn Larsen-Ball complaint, plaintiffs allege further that manufacturers enforce their policies through “threats” and “warnings” to retailers that violate them, but “opportunities to cure.”<sup>217</sup> For

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<sup>210</sup> *Leegin* (2007), 924.

<sup>211</sup> Horvath (2015), 5.

<sup>212</sup> *Costco Wholesale Corporation v. Johnson & Johnson Vision Care, Inc. Complaint and Demand for Jury Trial*, U.S. District Court for the Northern District of California, San Francisco Division, 14 (2015).

<sup>213</sup> *Costco Complaint and Demand for Jury Trial*, 12 (2015).

<sup>214</sup> *Costco Complaint* (2015), 12.

<sup>215</sup> *Costco Complaint* (2015), 12.

<sup>216</sup> *Costco Complaint* (2015), 13.

<sup>217</sup> *Marn Larsen-Ball v. Cooper Vision, Inc. et al, Class Action Complaint* 15 (2015).



example, once a violation is identified by a third-party auditor, Alcon is alleged to “ask[ed] to make a correction.”<sup>218</sup> If the violator refuses to increase its prices, Alcon is alleged to “punish the violation by prospectively denying access to the product for up to one year.”<sup>219</sup> Similar allegations are found for other manufacturers. Against the backdrop of the aforementioned circumstances, to the extent these allegations are shown to be true, it will be difficult for manufacturers to contend their pricing practices are, in fact, unilateral.

**Consequences of finding an agreement.** Should the pricing practices of contact lens manufacturers be found to involve an agreement, and therefore RPM, it could mean several things. *First*, it could be interpreted that the policies were unilateral in name only. That is, that the label “unilateral price policy” was pre-textual and contact lens manufacturers’ arrangements with retailers amounted to an agreement following past doctrine and pre-*Leegin* standards. *Second*, it could also be interpreted that the standard for finding an agreement has shifted post-*Leegin* to include the unilateral price policies of contact lens manufacturers. If this proves to be the case, it will confirm the predictions of those commentators who have interpreted the *Leegin* decision as yielding dual implications for the legal status of RPM. *Third* and last, should the pricing practices of contact lens manufacturers be found to involve an agreement it could mean that, as in many industries, contemporary relations between manufacturers and retailers in the contact lens industry have so changed as to render the development and implementation of unilateral price policies an implausible strategy and therefore such an improbable contention as to have been rejected. In this regard, the current debate surrounding contact lens manufacturers pricing practices possesses potential to contribute to contemporary understanding of the “standard of agreement” appropriate for future rule of reason analysis involving RPM.

### Directions for Analysis

Analyses that bear in mind the aforementioned insights should be helpful to ongoing assessments of the competitive implications of contact lens manufacturers’ pricing practices. In addition to factual proof that demonstrates the level and extent of manufacturer-retail interactions concerning the pricing practices of contact lens pricing practices, several additional analyses should be informative to the question of agreement. These analyses should include, for example, further assessment of the history and rationale underlying the prior standard of agreement and the sufficiency of this prior rationale given the rule of reason. These analyses should also include added assessment of emergent theories of agreement and their implications for a new standard of agreement. These analyses should further include assessment of the applicability and implications of broader and more general trends in channel management to the distribution of contact lenses. These trends identify that manufacturers and retailers are moving away from short-term and arm’s length dealings toward longer-term and more relational forms of interaction. To the extent these trends apply to the distribution of contact lens, they suggest the difficulties that manufacturers would have to overcome to be found to have developed and implemented a unilateral policy involving restrictive price practices.

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<sup>218</sup> Marn Larsen-Ball Complaint (2015), 15-16.

<sup>219</sup> Marn Larsen-Ball Complaint (2015), 16.

## COMPETITIVE HARMS

Depending on the approach adopted for the rule of reason,<sup>220</sup> a plaintiff may be required to offer proof that the use of RPM poses harmful effects or harmful tendencies for competition.<sup>221</sup> Numerous theoretical explanations for the anticompetitive effects of RPM have been developed over time. In addition, factors relevant to inquiries of RPM's harmful tendencies have been identified as well. These explanations and factors are relied upon in antitrust to explain the harmful effects and tendencies of practices that limit competition through restricting resale prices.<sup>222</sup> Consequently, they will be an important focus of inquiry in the current debate.

### Harmful Effects of RPM

**The forestalling innovation thesis.** The most historically relevant explanation of RPM's harmful effects involves its use to forestall price lowering forms of retail innovation. Scholars in economics, marketing, and law have long recognized that practices which restrict intrabrand competition adversely affect innovation brought about through more efficient (i.e., less costly)

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<sup>220</sup> Areeda & Hovenkamp (2006), ¶1633b (Describing the various approaches: "The typical rule of reason is a form of presumptive legality in the sense that the defendant prevails unless the plaintiff offers some proof of harmful effects or tendencies. Speaking generally, the typical plaintiff must show that the challenged conduct limits competition and that it does so significantly. ... The alternative is a variety of more structured approaches to the rule of reason. They vary in the first instance as to whether the plaintiff is required to make a prima facie showing of harm to competition or whether the restraint should be presumed harmful.").

<sup>221</sup> The approach to be taken by a court remains to be established. See *Leegin*, 898-99 (2007) ("As courts gain experience considering the effects of these restraints by applying the rule of reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses. Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones."). For arguments in favor of a rebuttable presumption of illegality, see Areeda & Hovenkamp (2006), ¶1633a, ¶1633e (Counseling against "... per se legality, per se illegality, or an open-ended rule of reason and suggest[ing] instead alternative arrays of presumptions" and recommending an approach that includes "prima facie illegality ... rebutting anticompetitive danger ... affirmative justifications."). Pamela Jones Harbour & Laurel A. Price, *RPM and the Rule of Reason: Ready or Not, Here We Come*, 55 ANTITRUST BULLETIN 223 (2010) ("We argue that a structured rule of reason, anchored by a rebuttable presumption of illegality, is the appropriate legal standard for analyzing resale price maintenance agreements between manufacturers and retailers."). Similarly, the AAI has advocated for a rebuttable presumption of illegality, see Foer (2014), 1 ("And it is also time for the agencies to assert leadership in formulating post-Leegin RPM doctrine by advocating a rebuttable presumption of anticompetitive harm for RPM agreements."). The European Commission approaches RPM as a "hard core" restriction for which it applies a presumption that RPM restricts competition, see Commission on the European Communities, Commission Notice: Vertical Restraint Guidelines (2010), ¶223 ("As explained in section III.3, resale price maintenance (RPM), that is agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer, are treated as a hardcore restriction. Including RPM in an agreement gives rise to the presumption that the agreement restricts competition and thus falls within Article 101(1). It also gives rise to the presumption that the agreement is unlikely to fulfil the conditions of Article 101(3), for which reason the block exemption does not apply. However, undertakings have the possibility to plead an efficiency defence under Article 101(3) in an individual case. It is incumbent on the parties to substantiate that likely efficiencies result from including RPM in their agreement and demonstrate that all the conditions of Article 101(3) are fulfilled. It then falls to the Commission to effectively assess the likely negative effects on competition and consumers before deciding whether the conditions of Article 101(3) are fulfilled.").

<sup>222</sup> Gregory T. Gundlach, Kenneth Manning & Joseph P. Cannon, *Resale Price Maintenance: A Review and Propositions for Research*, working paper (2015).

forms of retailing. A consistent theme across these fields is that RPM is widely recognized to have the effect of slowing down the pace of these retail innovations in ways that deny consumers access to the associated benefits of lower retail prices. Thus, RPM may be sought by retailers and adopted by manufacturers to forestall the price lowering effects of more efficient forms of retailing.

*Economic and business research.* As early as 1954, drawing on economic research at the time to describe the main economic issues associated with RPM, distribution economist Professor Basil Yamey wrote that “[p]erhaps the only general conclusion is that price maintenance tends to slow down the pace of change in retail markets, to delay changes in the shares of trade handled by different types of retail enterprise, and to discourage the development of ‘unorthodox’ methods of retailing.”<sup>223</sup> According to Yamey, RPM does not eliminate the possibility of modifications in the structure of retail distribution, but it generally works in favor of established firms by retarding change and by eliminating price competition, the most effective instrument of change.<sup>224</sup> More specifically, “by stopping price competition in retailing, the practice [of RPM] impedes the replacement of high-cost by low-cost forms of retailing, and of less efficient by more efficient firms.”<sup>225</sup> As concluded by Yamey, “the brake on price competition is especially severe on the development of new forms of retailing.”<sup>226</sup> A similar conclusion was reached by marketing scholar Stanley Hollander in 1966.<sup>227</sup> Drawing on marketing research and surveying the retail distribution environment at that time, Hollander wrote that “Almost thirty years’ use of price maintenance, with varying degrees of enforcement, shows it to be little more than a futile and costly barrier to change and competition in marketing.”<sup>228</sup> During the period discount retailers had become an increasingly prominent form of retailing in the United States. According to Professor Hollander “the major impact of RPM was to “temporarily bottle up some economic forces, thereby disadvantaging the consumer, until discounting and private branding ultimately and painfully induced its collapse.”<sup>229</sup> As concluded by Professor Hollander, “[t]he results clearly have been undesirable from the point of view of consumers and the economy as a whole.”<sup>230</sup> Over time researchers in economics and business have also reported empirical evidence that is consistent with resellers using RPM to hinder innovation of more efficient, low price retail channels. Researchers have also elaborated on the evolutionary forces through which RPM acts to impede retail innovation. Studying the drug store channel, researcher Weiss reports in 1971 that the use of RPM may have constrained retail innovation in the resale of drugs and related goods.<sup>231</sup> In 1994, researchers Warnaby and Upton report that innovation in the retail sale of books had been retarded by a national book agreement that was a form of RPM.<sup>232</sup> Most recently in 2015, other authors have examined the evolutionary

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<sup>223</sup> BASIL S. YAMEY, THE ECONOMICS OF RESALE PRICE MAINTENANCE 86 (1954).

<sup>224</sup> Yamey (1954).

<sup>225</sup> Yamey (1954), 5.

<sup>226</sup> Yamey (1954).

<sup>227</sup> Stanley C. Hollander, *Resale Price Maintenance: United States of America*, in RESALE PRICE MAINTENANCE: A COMPARATIVE AMERICAN-EUROPEAN PERSPECTIVE, EDITED BY BASIL S. YAMEY 65 (1966).

<sup>228</sup> Hollander (1966).

<sup>229</sup> Hollander (1966).

<sup>230</sup> Stanley C. Hollander, *The ‘One-Price’ System, Fact or Fiction?*, 31 JOURNAL OF RETAILING 127 (1955).

<sup>231</sup> LEONARD W. WEISS, CASE STUDIES IN AMERICAN INDUSTRY (1971).

<sup>232</sup> Gary Warnaby & Joanne Upton, *Are Books Different? The Impact of Price on Retail Market Development*, 22 INTERNATIONAL JOURNAL OF RETAIL & DISTRIBUTION MANAGEMENT 13 (1994).



forces through which RPM acts to forestall retail innovation proposing that “The long-term retention of RPM leads to: (a) higher resale prices; (b) constraints on reseller price strategies and price competition; and (c) barriers for innovative marketing and retailing strategies that result in lower prices.”<sup>233</sup>

**Enforcement agencies.** Drawing on these findings and others, relevant enforcement agencies, have also offered similar conclusions regarding the adverse effects of RPM on price lowering innovation. The theoretical basis and historical significance of RPM as an anticompetitive method for preventing more efficient retailers from competing on lower prices was described by the FTC in a staff report published in 1985.<sup>234</sup> Identified at the time as “the most popular, and historically possibly the most important, [anticompetitive] explanatory hypothesis for resale price maintenance,”<sup>235</sup> the FTC staff report described how “RPM could be viewed by ‘traditional’ or ‘full-priced’ dealers ... as a means of preventing the emergence of more efficient forms of distribution.”<sup>236</sup> According to the FTC staff report, traditional retailers, wanting to find a way to protect themselves against discounters may combine to coerce manufacturers into the establishment of an RPM program. As explained in the staff report:

“Under this theory, the manufacturer is induced into instituting a resale-pricing scheme that yields retailers a higher margin than otherwise would be the case. More efficient retailers, or retailers who otherwise would be induced to compete on a lower price basis, are prevented from offering prices lower than the maintained price. Resellers who deviate from the maintained price can then be detected, either by the manufacturer or the colluding retailers, and subjected to some form of discipline from the manufacturer. The manufacturer could discontinue selling to the price cutter or adopt some”<sup>237</sup>

With RPM, according to the FTC staff report, “neither the dealer who cuts costs nor the new entrant with a better business method can grow by reducing prices on price maintained brands.” Thus, widespread use of RPM can work to “inhibit initiative and innovation at the distribution level.” According to the FTC, staff report, “Several analysts have reviewed the historical evidence ... and concluded that the dealers were motivated to some extent to prevent the growth of more efficient types of distribution.”<sup>238</sup> More recent statements by those at the FTC echo

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<sup>233</sup> Gundlach, Manning & Cannon (2015).

<sup>234</sup> Thomas R. Overstreet, *Resale Price Maintenance: Economic Theories and Empirical Evidence*, Bureau of Economics Staff Report to the Federal Trade Commission, 13 footnote 1 (1983).

<sup>235</sup> Overstreet (1983), 13.

<sup>236</sup> Overstreet (1983), 14, footnote 1.

<sup>237</sup> Overstreet (1983), 13-14.

<sup>238</sup> Overstreet (1983), 14, footnote 1 (The examples cited in this source involved organized dealer activities in the form of dealers’ trade associations and were apparently successful only temporarily. Thus, the FTC also examined “how high-cost distributors could successfully predate upon their more efficient rivals indefinitely.” As discussed in their report “..., discounters and traditional dealers might differ in ways other than simply the levels of their average costs. For example, the volume of sales necessary to achieve minimum efficient scale of operation (MES), and the rate at which per unit average costs rise with sales volumes less than MES could also differ between the two types of distributors. If the inability to discount price-maintained goods and expand sales and achieve lower average costs disadvantages the discounters relative to the traditional dealers, then RPM could effectively inhibit the rate of growth of the new type of dealers, at least in the short run. For the above scenario to apply, RPM must be sufficiently widespread to disadvantage discounters by adversely affecting their scale of operation and preventing their average costs from falling. Thus, RPM either would have to be enforced upon a number of brands which collectively could account for a substantial amount of a dealer’s total sales, or on an individual brand with a very large market share sold primarily through narrow-line specialty outlets. Otherwise consumer and/or supplier substitution possibilities would undermine the effective-ness of such a collusive scheme.”).

innovation related concerns for RPM. In 2010, as described by past FTC Commissioner Pamela Harbour Jones and FTC staff attorney Laurel A. Price, “... as a general matter RPM traditionally has been motivated by a desire to suppress innovative and socially desirable forms of competition that are likely to lead to lower prices and expanded output.”<sup>239</sup> As both authors point out, “Innovations in the distribution of consumer goods tend to deliver progress because they threaten the viability of the status quo. RPM, in stark contrast, has always been the champion of the status quo, which is precisely why RPM is favored by those who wish to retard effective innovation competition.”<sup>240</sup> Extending the past role of RPM in retarding innovation to the e-commerce era, Commissioner Harbour Jones and staff member Price conclude:

“In recent years, traditional RPM justifications have been refreshed and reinvigorated for the modern and rapidly evolving e-commerce era. As consumers already have realized, Internet retailing offers the potential of tremendous savings, especially when innovative Internet entrepreneurs choose to share with consumers a portion of their cost reductions from distribution and other efficiencies. From the perspective of traditional merchants, however – especially those dependent on physical retailing space – Internet-only retailing is perceived as a threat to existing business models. Increasingly, aggressive RPM programs are being viewed as an effective way to thwart innovative Internet retailers who might seek to upset the status quo by passing savings through to consumers in the form of discounts.”<sup>241</sup>

Like the FTC, similar innovation based concerns for RPM have been reported by other enforcement agencies. For example, as described in the Guidelines on Vertical Restraints offered by the European Commission in 2014:

“RPM may reduce dynamism and innovation at the distribution level. By preventing price competition between different distributors, RPM may prevent more efficient retailers from entering the market and/or acquiring sufficient scale with low prices. It also may prevent or hinder the entry and expansion of distribution formats based on low prices, such as price discounters.”<sup>242</sup>

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<sup>239</sup> Harbour (2010), 229.

<sup>240</sup> Harbour (2010), 229-230.

<sup>241</sup> Harbour (2010), 232.

<sup>242</sup> Commission on the European Communities, Commission Notice: Vertical Restraint Guidelines (2010), ¶224 (“RPM may restrict competition in a number of ways. Firstly, RPM may facilitate collusion between suppliers by enhancing price transparency in the market, thereby making it easier to detect whether a supplier deviates from the collusive equilibrium by cutting its price. RPM also undermines the incentive for the supplier to cut its price to its distributors, as the fixed resale price will prevent it from benefiting from expanded sales. This negative effect is in particular plausible if the market is prone to collusive outcomes, for instance if the manufacturers form a tight oligopoly and a significant part of the market is covered by RPM agreements. Secondly, by eliminating intra-brand price competition, RPM may also facilitate collusion between the buyers, i.e. at the distribution level. Strong or well organized distributors may be able to force/convince one or more suppliers to fix their resale price above the competitive level and thereby help them to reach or stabilise a collusive equilibrium. This loss of price competition seems especially problematic when the RPM is inspired by the buyers, whose collective horizontal interests can be expected to work out negatively for consumers. Thirdly, RPM may more in general soften competition between manufacturers and/or between retailers, in particular when manufacturers use the same distributors to distribute their products and RPM is applied by all or many of them. Fourthly, the immediate effect of RPM will be that all or certain distributors are prevented from lowering their sales price for that particular brand. In other words, the direct effect of RPM is a price increase. Fifthly, RPM may lower the pressure on the margin of the manufacturer, in particular where the manufacturer has a commitment problem, i.e. where he has an interest in lowering the price charged to subsequent distributors. In such a situation, the manufacturer may prefer to agree to RPM, so as to help it to commit not to lower the price for subsequent distributors and to reduce the pressure on its own margin. Sixthly,

*Supreme Court.* In addition to the FTC and other enforcement agencies, RPM's adverse impact on more efficient price lowering forms of distribution has been acknowledged by the U.S. Supreme Court. In *Leegin*, the Court observed that "[v]ertical price restraints also might be used to organize cartels at the retailer level."<sup>243</sup> As described by the Court:

"[a] group of retailers might collude to fix prices to consumers and then compel a manufacturer to aid the unlawful arrangement with resale price maintenance. In that instance the manufacturer does not establish the practice to stimulate services or to promote its brand but to give inefficient retailers higher profits. Retailers with better distribution systems and lower cost structures would be prevented from charging lower prices by the agreement."<sup>244</sup>

Citing the market power of one professional association (e.g., the National Association of Retail Druggists) to compel manufacturers to use RPM, the Court concluded that "historical examples suggest this possibility is a legitimate concern."<sup>245</sup> Relatedly, according to the Court, "Resale price maintenance, furthermore, can be abused by a powerful manufacturer or retailer."<sup>246</sup> In this circumstance, as described by the Court, "A dominant retailer, for example, might request resale price maintenance to forestall innovation in distribution that decreases costs. A manufacturer might consider it has little choice but to accommodate the retailer's demands for vertical price restraints if the manufacturer believes it needs access to the retailer's distribution network."<sup>247</sup> In similar terms, the *Leegin* Court has also acknowledged that the use of RPM to shield inefficient retailers' profits by preventing more innovative retailers from charging lower prices may also benefit manufacturers who themselves want to maintain a higher margin. As described by the Court, "... unlawful pricing fixing, designed to obtain monopoly profits, is an ever-present temptation."<sup>248</sup> According to the Court:

"Resale price maintenance may, for example, facilitate a manufacturer cartel. ... An unlawful cartel will seek to discover if some manufacturers are undercutting the cartel's fixed prices they offer. Resale price maintenance furthermore could discourage a manufacturer from cutting prices to retailers with the concomitant benefit of cheaper prices to consumers."<sup>249</sup>

Warning of the anticompetitive effects of shielding inefficient retailers' profits by the use of RPM resulting from both retailer and manufacturer cartels, the *Leegin* Court instructed future courts that "[t]o the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel, it, too, would need to be held unlawful under the rule of reason."<sup>250</sup>

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RPM may be implemented by a manufacturer with market power to foreclose smaller rivals. The increased margin that RPM may offer distributors, may entice the latter to favour the particular brand over rival brands when advising customers, even where such advice is not in the interest of these customers, or not to sell these rival brands at all. Lastly, RPM may reduce dynamism and innovation at the distribution level. By preventing price competition between different distributors, RPM may prevent more efficient retailers from entering the market and/or acquiring sufficient scale with low prices. It also may prevent or hinder the entry and expansion of distribution formats based on low prices, such as price discounters.").

<sup>243</sup> *Leegin* (2007), 893.

<sup>244</sup> *Leegin* (2007), 893.

<sup>245</sup> *Leegin* (2007), 893.

<sup>246</sup> *Leegin* (2007), 893.

<sup>247</sup> *Leegin* (2007), 893.

<sup>248</sup> *Leegin* (2007), 892.

<sup>249</sup> *Leegin* (2007), 892.

<sup>250</sup> *Leegin* (2007), 893.

**Antitrust scholars.** Finally, antitrust scholars have long warned against the adverse effects of RPM for price lowering innovation. For example, noted antitrust scholar Professor Lawrence Sullivan concluded in 1985 that retailing innovations brought by “the department store, the supermarket, the mail-order firm, the discount store; the boutique, and others” have added “to the variety and . . . choice open to consumers” and “many have reduced the cost” for consumers.<sup>251</sup> These innovations could have been “slowed or even stifled” if manufacturers could employ a full range of vertical restraints including RPM.<sup>252</sup> Echoing these concerns in 1997, noted antitrust distribution scholar Robert Steiner concludes that: “growth of . . . more efficient new retailing forms often has been seriously retarded by their inability to obtain well-known manufacturers’ brands, free of RPM.”<sup>253</sup> Elaborating on these concerns in 2006, treatise authors Professors Areeda and Hovenkamp describe that “When resale prices are not fixed, price competition among dealers favors the expansion of those with efficient scale and methods, thus lowering the cost of distribution. Resale price maintenance impedes that process . . .”<sup>254</sup> Most recently in 2010, summarizing historical knowledge of the nature and extent of injury arising from the adverse impacts of RPM, respected antitrust scholar Professor Warren Grimes concludes that,

“[w]hether the motivation for RPM comes from retailers who wish to avoid discount competition or from a manufacturer who wants to maintain a high margin, the impact of RPM is to deny an efficient retailer the potent weapon of a lower price in gaining market share against rivals. New and efficient retailing methods can be slowed or stymied by widespread use of RPM. This point has been made over and over again by students of RPM.”<sup>255</sup>

**Factors relevant to understanding RPM’s harmful tendencies.** In addition to explanations of how RPM can harm competition, antitrust scholars and Courts have also identified factors associated with the adverse effects of RPM. These factors reflect antecedent circumstances that foreshadow the harmful competitive effects of RPM.

**Antitrust scholarship.** Scholars have identified numerous factors associated with RPM’s harmful effects.<sup>256</sup> These include manufacturer concentration, retailer concentration, widespread market coverage of RPM, retailer initiatives for RPM, RPM involving powerful brands, the presence of dominant retailers, selective application of RPM, RPM involving homogeneous products, government regulation of production or distribution, and RPM applied to a large volume of sales as associated with the adverse effects of RPM. Manufacturer coordination to use RPM is a greater danger when the manufacturer market is concentrated. Coordination of retailers through RPM is also a greater danger when the retail market is concentrated. RPM that covers a

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<sup>251</sup> Oversight Hearings of the Antitrust Division of the Dep’t of Justice, Subcomm. on Monopolies and Commercial Law, H. Comm. on the Judiciary, 99th Cong. (1985) (statement of Professor Lawrence A. Sullivan). See Phillip Areeda & Hovenkamp (2006), ¶1632.

<sup>252</sup> Sullivan (1985). Areeda & Hovenkamp (2006), ¶1632.

<sup>253</sup> Robert L. Steiner, *How Manufacturers Deal With the Price-Cutting Retailer: When are Vertical Restraints Efficient?*, 65 ANTITRUST LAW JOURNAL 424(1997).

<sup>254</sup> Areeda & Hovenkamp (2006), ¶1632c4.

<sup>255</sup> Warren S. Grimes, *A Dynamic Analysis of Resale Price Maintenance: Inefficient Brand Promotion, Higher Margins, Distorted Choices, and Retarded Retailer Innovation*, 55 ANTITRUST BULLETIN 101 (2010).

<sup>256</sup> Areeda & Hovenkamp (2006), ¶1633c (Describing “The factors most often associated with adverse effects from resale price maintenance...”).

large portion of a retail market reduces both interbrand and intrabrand competition leaving consumers with few unrestrained alternatives. Widespread coverage may also mean that manufacturers use the restraint to induce dealer recommendations that deceive consumers. Dealer initiated RPM may indicate the exercise of buyer power individually or collectively. Where RPM is used in association with a powerful brand, manufacturers may more easily impose RPM and retailers have the incentive restrain competition from other retailers. A dominant retailer may be more difficult for a manufacturer to replace without some loss of market momentum and perhaps other tangible costs and they may have power over the manufacturer. The selective use of RPM in a market is a possible indicator that dealer power in those markets accounts for the restraint. Application of RPM to homogeneous products suggests its illegitimacy given the most relevant justifications for RPM theorize its use to differentiate a product. Other factors include circumstances that reward successful coordination (manufacturer or retailer) and circumstances that reward the successful exercise of individual market power (manufacturers or retailer). This could include, for example, governmental regulation that limits entry into production or distribution. It could also include other unique features of the circumstances that make the potential of harmful effects from RPM more likely.

*Supreme Court's Leegin Factors.* The Supreme Court has itself identified factors relevant to inquiries of RPM's harmful tendencies. In acknowledging that "resale price maintenance has economic dangers," in *Leegin*, the Supreme Court warned that, "courts would have to be diligent in eliminating their anticompetitive uses from the market."<sup>257</sup> To assist in this effort, the Court held that "factors relevant to the inquiry are the number of manufacturers using the practice, the restraint's source, and a manufacturer's [and retailer's] market power."<sup>258</sup> Based on historical understanding of RPM's harmful effects these factors represent a subset of factors identified by antitrust scholars to be associated with RPM's harmful effects. These factors are known as the "*Leegin Factors*."<sup>259</sup>

According to the Supreme Court, "*the number of manufacturers that make use of the practice in a given industry can provide important instruction*" for identifying anticompetitive uses of RPM.<sup>260</sup> The more widespread RPM is found in a market the less chance competition from other manufacturers can undercut its use to facilitate a manufacturer cartel or that competition can defeat its use to facilitate a retailer cartel.<sup>261</sup> Consequently, as explained by the Court, "resale price maintenance should be subject to more careful scrutiny, ... if many

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<sup>257</sup> Leegin (2007), 630.

<sup>258</sup> Leegin (2007), 630.

<sup>259</sup> Robert L. Steiner, *The Leegin Factors – a Mixed Bag*, 55 ANTITRUST BULLETIN 25 (2010).

<sup>260</sup> Leegin (2007), 897.

<sup>261</sup> Leegin (2007), 897 ("When only a few manufacturers lacking market power adopt the practice, there is little likelihood it is facilitating a manufacturer cartel, for a cartel then can be undercut by rival manufacturers. Overstreet (1983), 22. Bork, 294. Likewise, a retailer cartel is unlikely when only a single manufacturer in a competitive market uses resale price maintenance. Interbrand competition would divert consumers to lower priced substitutes and eliminate any gains to retailers from their price-fixing agreement over a single brand. See Posner, 172; Bork, 292. Resale price maintenance should be subject to more careful scrutiny, by contrast, if many competing manufacturers adopt the practice. Cf. Scherer & Ross (1990), 558 (noting that "except when [resale price maintenance] spreads to cover the bulk of an industry's output, depriving consumers of a meaningful choice between high-service and low-price outlets, most [resale price maintenance arrangements] are probably innocuous"). Easterbrook, 162 (suggesting that "every one of the potentially-anti-competitive outcomes of vertical arrangements depends on the uniformity of the practice").")

competing manufacturers adopt the practice.”<sup>262</sup> Widespread retail coverage of RPM leaves consumers with few unrestrained choices<sup>263</sup> and can raise prices and limit output for an entire product category.<sup>264</sup> Consequently, to benefit from these restrained choices and outcomes, retailers may coordinate to obtain adoption of RPM<sup>265</sup> and manufacturers may coordinate to adopt RPM.<sup>266</sup> Widespread use of RPM may also mean that multibrand retailers are deceptively pushing their price-fixed brands and that this use of RPM is serious enough to induce rival manufacturers to match the restraint by adopting RPM in order to entice retailers to push their own brands.<sup>267</sup> These effects flow from the extensive use of RPM with multibrand dealers, aside from other objectives.<sup>268</sup> Apart from collusion, widespread use of RPM may also result from institutional forces, acting through coercive, normative, and mimetic processes, to induce manufacturers to adopt RPM.<sup>269</sup>

In addition to the number of manufacturers that make use of RPM, according to the Court in *Leegin*, “the source of the restraint may also be an important consideration.”<sup>270</sup> If the impetus is retailers, there is a greater likelihood that RPM facilitates a cartel among retailers, or that RPM supports a dominant, inefficient retailer.<sup>271</sup> In contrast, according to the Court, if RPM is adopted by a manufacturer independent of retailer pressure, the restraint is less likely to promote anticompetitive conduct by manufacturers.<sup>272</sup> Thus, according to the Court (quoting another source) “it makes all the difference whether minimum retail prices are imposed by the manufacturer in order to evoke point-of-sale services or by the dealers in order to obtain monopoly profits.”<sup>273</sup> Moreover, “a manufacturer also has an incentive to protest inefficient

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<sup>262</sup> *Leegin* (2007), 897.

<sup>263</sup> Areeda & Hovenkamp (2006), ¶1633c (Describing the effects of widespread market coverage of RPM: “consumers are left with few unrestrained alternatives.”).

<sup>264</sup> Scherer & Ross (1990), 558. F.M. Scherer, *The Economics of Vertical Restraints*, 52 ANTITRUST LAW JOURNAL 702 (1983).

<sup>265</sup> Areeda & Hovenkamp (2006), ¶1633c (Describing that in relation to the widespread coverage of RPM, “Dealers therefore have an incentive to seek the vertical restraint.”).

<sup>266</sup> Areeda & Hovenkamp (2006), ¶1633c (“Resale price maintenance can be dangerous when it covers a large portion of the retail market. In that event, the restraint reduces interbrand competition.”).

<sup>267</sup> Areeda & Hovenkamp (2006), ¶1633c (“Where multibrand dealers are typical, moreover, widespread coverage within the manufacturers’ market may also mean that the manufacturers use the restraint to induce dealer recommendations that deceive consumers.”). Areeda & Hovenkamp (2006), ¶1633c (“Additionally, in the case of multibrand dealers, widespread restraints suggest that dealers may be deceptively pushing price-fixed products, the effect is serious enough to induce rival manufacturers to match the restraint, and that manufacturers individually will find it hard to abandon.”).

<sup>268</sup> Areeda & Hovenkamp (2006), ¶1633c (“These effects tend to flow simply from extensive use of the restraint with multibrand dealers, notwithstanding the simultaneous promotion of different and legitimate manufacturer objectives.”).

<sup>269</sup> Gundlach, Manning & Cannon, (2015).

<sup>270</sup> *Leegin* (2007), 897.

<sup>271</sup> *Leegin* (2007), 897-8 (“If there is evidence retailers were the impetus [\*898] for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer. See Brief for William S. Comanor et al. as Amici Curiae 7-8.”).

<sup>272</sup> *Leegin* (2007), 898 (“If, by contrast, a manufacturer adopted the policy independent of retailer pressure, the restraint is less likely to promote anticompetitive conduct.”).

<sup>273</sup> *Leegin* (2007), 898 (“Cf. Posner 177 (“It makes all the difference whether minimum retail prices are imposed by the manufacturer in order to evoke point-of-sale services or by the dealers in order to obtain monopoly profits.”) A manufacturer also has an incentive to protest inefficient retailer-induced [\*\*2720] price restraints because they can harm its competitive position.”).



retailer-induced price restraints because they can harm its competitive position.”<sup>274</sup> Retailers may act collectively or a dominant retailer may act alone to forestall lower price forms of retail innovation. In each case, RPM is initiated at the request or demand of the retailers. Collective action on the part of retailers involves a request or demand by two or more retailers acting in concert or through some other association (e.g., an association of retailers).<sup>275</sup> A dominant dealer is one that accounts for a sufficient amount of manufacturer dependence as to obtain their action to impose RPM.<sup>276</sup> In both instances, “buyer” power may be indicated if RPM is adopted or enforced after the request or demand of retailers or a retailer.<sup>277</sup>

Finally, according to the Court in *Leegin*, “that a dominant manufacturer or retail can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless *the relevant entity has market power*.”<sup>278</sup> If a manufacturer lacks market power, there is less likelihood that the manufacturer can use RPM to keep their competitors away from distribution outlets.<sup>279</sup> If a retailer lacks market power, manufacturers likely can sell their goods through rival retailers.<sup>280</sup> Consequently, as explained by the Court, “that a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power.”<sup>281</sup> Antitrust is concerned with the ability of market participants to distort the competitive process in substantial and nontransitory ways.<sup>282</sup> From an economic perspective, market power is keyed to the concept of inelasticity of demand.<sup>283</sup> Market power has been defined in antitrust as the ability of a seller to raise and sustain a price increase without losing so many sales that the seller must rescind the increase.<sup>284</sup> The most widely employed approach for measuring market power is to define the relevant market and to examine market shares, entry barriers and potential competition.<sup>285</sup> Adjustments to this approach may be made given the purpose of the exercise and the nature of the circumstances.<sup>286</sup> Market power may also be indicated through conduct that reflects the exercise of market power.

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<sup>274</sup> *Leegin* (2007), 898.

<sup>275</sup> Areeda & Hovenkamp (2006), ¶1633c (“‘Collective dealer action’ is a request or demand by two or more dealers acting in concert or by an association of dealers.”).

<sup>276</sup> Areeda & Hovenkamp (2006), ¶1633c (“A ‘dominant’ dealer is one that accounts for 30 percent of a manufacturer’s local or total sales of a brand – local when prices are fixed in only a few areas and total when the manufacturer employs the restraint generally.” “A dealer... may be difficult for the manufacturer to replace without some loss of market momentum and perhaps other tangible costs as well and thus may have some ‘power’ over the manufacturer.”).

<sup>277</sup> Areeda & Hovenkamp (2006), ¶1633c (“‘Dealer power’ may also be indicated by a restraint that was adopted or enforced after request or demand by dealers acting collectively or adopted after request by a ‘dominant’ dealer.”).

<sup>278</sup> *Leegin* (2007), 898.

<sup>279</sup> *Leegin* (2007), 898 (“And if a manufacturer lacks market power, there is less likelihood it can use the practice [\*\*\*642] to keep competitors away from distribution outlets.”).

<sup>280</sup> *Leegin* (2007), 898 (“If a retailer lacks market power, manufacturers likely can sell their goods through rival retailers.”).

<sup>281</sup> *Leegin* (2007), 898.

<sup>282</sup> Sullivan (2006), 25.

<sup>283</sup> Sullivan (2006), 25.

<sup>284</sup> Sullivan (2006), 26.

<sup>285</sup> Sullivan (2006), 33.

<sup>286</sup> Sullivan (2006), 33 (citing the Justice Department/FTC 1992 Horizontal Merger Guidelines call for an adjustment in product market definitions based upon the degree to which products are differentiated or there exists a closeness of products as substitutes in a differentiated market).

## Implications for the Current Debate

Should the pricing practices of contact lens manufacturers be found to meet the requisite standard of agreement, an important inquiry in the current debate will involve assessment of any harms to competition. Thus, an important question involves what competitive harms will be identified. Depending on the rule of reason approach applied, plaintiffs may be required to offer proof that the use of RPM poses harmful tendencies or proof that it causes harmful effects for competition. Antitrust scholars and the Supreme Court have identified different factors relevant to inquiries of RPM's harmful tendencies and the most historically relevant explanation of RPM's harmful effects is that RPM results in higher retail prices through forestalling cost lowering innovations in distribution. Consequently, these factors and effects will be important considerations in the debate.

**Applicability of factors for understanding RPM's harmful tendencies.** As previously described, antitrust scholars and the Supreme Court have identified factors associated with the harmful tendencies of RPM. These factors foreshadow the adverse effects of RPM.

**Analyses of the *Leegin* factors.** Relying on public information, at least one analysis applying the *Leegin* factors to the pricing practices of contact lens manufacturers has concluded that "Public information indicates that the proliferation of UPPs is likely anticompetitive based on an application of the relevant factors articulated by the Court in *Leegin*..."<sup>287</sup> According to the American Antitrust Institute (AAI), "the first *Leegin* factor is met" based upon the knowledge that between June 2013 and September 2014, the four major contact lens manufacturers implemented UPPs on one or more brands, and it appears that at least forty percent of the market is now covered by UPPs."<sup>288</sup> This figure has since increased to well over 50 percent of the market being covered by UPPs. Although not possessing information as to whether retailers or manufacturers were the original source of the UPPs, according to the AAI, "The second factor may also be satisfied"<sup>289</sup> given "eye care providers -- a key group of retailers -- have reacted very positively to the developments."<sup>290</sup> Citing public information, ECPs have reportedly "welcomed the restrictions on price competition because it protects their margins on contact lens sales."<sup>291</sup> Moreover, based on past lawsuits and other actions, "history suggests that eye care providers may be the moving force behind UPPs."<sup>292</sup> In the past, ECPs also reportedly "have sought to choke off competition from retail rivals"<sup>293</sup> and to preserve a captive customer base, "have also

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<sup>287</sup> Foer (2014), 2.

<sup>288</sup> Foer (2014), 4.

<sup>289</sup> Foer (2014), 4.

<sup>290</sup> Foer (2014), 4.

<sup>291</sup> Foer (2014), 4 (citing Statement of R. Joe Zeidner, General Counsel, 1-800 CONTACTS, Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights, 1 (July 30, 2014), at 8-9; Maria Sampalis, *Minimum Pricing on Contact Lenses: A Win for Independent ODs*, REVIEW OPTOMETRIC BUSINESS (Dec. 30, 2013).

<sup>292</sup> Foer (2014), 4.

<sup>293</sup> Foer (2014), 4 (citing the Statement of R. Joe Zeidner, General Counsel, 1-800 CONTACTS, Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights, 1 (July 30, 2014), at 8-9 and *In re Disposable Contact Lens Antitrust Litigation*, 2001 U.S. Dist. LEXIS 5499 (M.D. Fla. 2001)).

resisted giving patients a copy of their prescription.”<sup>294</sup> Finally, according to the AAI, “The third *Leegin* factor unquestionably applies to the contact lens market.”<sup>295</sup> Citing the findings of others, “Johnson & Johnson has a market share of 35 percent and the four leading manufacturers have a collective share of 97 percent.”<sup>296</sup> The market share of Johnson & Johnson has since grown to 43.2% and the collective share of the four leading manufacturers has grown to nearly 99%. In addition, “all four have instituted UPPs on at least some of their brands.”<sup>297</sup> To the extent the analysis by the AAI is correct, it indicates that based upon the *Leegin* factors identified by the Supreme Court, the pricing practices of contact lens manufacturers possess significant potential and tendencies to harm competition.

**Other analyses.** Analysis of the widespread use of restrictive pricing practices and the way in which retailers convey their desire to prescribe price restricted lenses (i.e., an aspect of the source of the restraint) is offered by the Information Technology and Innovation Foundation.<sup>298</sup> Given its focus on the way in which retailers convey their desire for price restrictions, the analysis informs understanding of the *Leegin* Factors. In congressional testimony President and Founder Robert Atkinson describes that relative to the widespread use of restrictive pricing practices in the contact lens industry, “The best way to understand UPP policy is by looking at game theory and in particular in the prisoner’s dilemma game.”<sup>299</sup> According to Atkinson, “Contact lens manufacturers are in their own prisoners’ dilemma.”<sup>300</sup> Like prisoners in the game, their optimal strategy is to cooperate and sell all their lenses without UPP. Such an agreement would benefit the industry because contact lens wearers would pay lower prices and therefore replace their lenses more often, leading to higher industry sales. However, “If both consumers and the manufacturers would benefit from widely distributed lenses, why have many contact lens manufacturers announced UPP policies?”<sup>301</sup> According to Atkinson:

“The answer is that like a prisoner ratting on his fellow prisoners so he can get off, each individual lens producer can gain market share over other manufacturers by selling UPP lens. Optometrists will be more likely to sell UPP lenses because they will know that

<sup>294</sup> Foer (2014), 4 (citing the Statement of R. Joe Zeidner, General Counsel, 1-800 CONTACTS, Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights, 1 (July 30, 2014), at 4-5).

<sup>295</sup> Foer (2014), 5 (citing the Statement of R. Joe Zeidner, General Counsel, 1-800 CONTACTS, Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights, 1 (July 30, 2014), at 5).

<sup>296</sup> Foer (2014), 5 (citing market share figures from the Statement of R. Joe Zeidner, General Counsel, 1-800 CONTACTS, Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights, 1 (July 30, 2014), at 5).

<sup>297</sup> Foer (2014), 5 (citing market share figures from the Statement of R. Joe Zeidner, General Counsel, 1-800 CONTACTS, Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights, 1 (July 30, 2014), at 5).

<sup>298</sup> Atkinson (2014), 1.

<sup>299</sup> Atkinson (2014), 1. The prisoner’s dilemma is a type of non-zero-sum game in which two players try to get rewards from a jailer by cooperating with or betraying the other player. In the prisoner’s dilemma, an individual has a strong incentive to defect (i.e., to claim that they are innocent and their partner is guilty), so that the only possible equilibrium for the game is for all players to defect.

<sup>300</sup> Atkinson (2014), 1.

<sup>301</sup> Atkinson (2014), 1.

their customer cannot find a better price by going online or to a big box distributor. By selling UPP lenses that virtually guarantee patient lock in, contact lens producers knows that optometrists are much more likely to prescribe their company's lenses."<sup>302</sup> The author thus concludes that, "..., UPP will likely be the industry-wide pricing policy because optometrists have a strong financial incentive to prescribe UPP lenses and will favor companies that provide them."<sup>303</sup>

In addition to insights regarding how contact lens manufacturers' restrictive pricing policies have become widespread, Atkinson goes on to describe how "optometrists convey this desire to prescribe UPP lens to producers?"<sup>304</sup> Thus, the author offers insights into the source of the pricing policies. As told by Atkinson, "The answer is in large part through professional norms."<sup>305</sup> Quoting scholarship that addresses anticompetitive social norms as antitrust violations:<sup>306</sup> "Robust, anti-competitive, price fixing social norms may flourish in a market structure of low entry barriers and very low concentration levels."<sup>307</sup> According to Adkinson: "In the case of the eye care industry, the collusion may not be in a smoke-filled room, but it's collusion all the same. In this case, it's professional collusion through norms that is leading producers to adopt UPP policies."<sup>308</sup>

The author observes that these anticompetitive social norms are expressed in a variety of ways including articles in professional journals, on social media and meetings with industry representatives.<sup>309</sup> He goes on to document examples of these sources and their effects in conveying optometrists desire to prescribe price restricted lenses.

*Consideration of other factors.* Additional factors beyond those identified in *Leegin* and understood to be associated with the adverse effects of RPM include manufacturer concentration, RPM involving powerful brands, the presence of dominant retailers, selective application of RPM, RPM involving homogeneous products, government regulation of production or distribution, and RPM applied to a large volume of sales. As previously described, the contact lens industry has witnessed increased consolidation over time thereby increasing concentration.<sup>310</sup> Higher concentration increases the potential of manufacturer coordination to use RPM. Although varying in application across established and new products, the restrictive pricing practices of contact lens manufacturers reportedly apply to a large portion of the retail

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<sup>302</sup> Atkinson (2014), 1.

<sup>303</sup> Atkinson (2014), 1.

<sup>304</sup> Atkinson (2014), 1.

<sup>305</sup> Atkinson (2014), 1.

<sup>306</sup> Dean Harvey, *Anticompetitive Social Norms as Antitrust Violations*, 94 CALIFORNIA LAW REVIEW 3 (2006),

<http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1261&context=californialawreview>.

<sup>307</sup> Atkinson (2014), 1.

<sup>308</sup> Atkinson (2014), 1.

<sup>309</sup> Atkinson (2014), 1.

<sup>310</sup> See *infra* industry. MaGure (2015), 70 (Addressing factors relevant to inquires of the harmful tendencies of RPM, "So now you have to go to court and prove under what's called a rule of reason whether or not that policy violates the law. And some of the triggers they talked about that would be clear triggers of violation would be is this a small or concentrated marketplace. Well there are only four vendors that represent 98%. That's fairly concentrated.")). Klobuchar (2014), 4 ("But the fact is that the contact lens market is relatively concentrated.").

market for contact lenses.<sup>311</sup> This reduces interbrand and intrabrand competition and leaves consumers with few unrestrained alternatives. It may also mean that manufacturers are employing the restraint to induce dealer recommendations that deceive consumers. Some of the brands to which contact lens manufacturers pricing practices apply involve brands with brand equity.<sup>312</sup> This indicates that manufacturers may more easily impose RPM and retailers have the incentive to restrain competition from other retailers. Retail and wholesale intermediaries through which contact lens manufacturers sell include dominant intermediaries and collectives.<sup>313</sup> Thus, it may be more difficult for manufacturers to replace them without some loss of market momentum and perhaps other tangible costs; thereby providing the intermediaries with power to request or demand RPM. The pricing practices of contact lens manufacturers have reportedly been selectively applied to products.<sup>314</sup> This may be an indicator that retailer power in those markets accounts for the restraint. Given the most relevant justifications for RPM theorize its use to differentiate a product, the occurrence and perception of different brands of contact lenses as a mass produced, relatively undifferentiated, and homogeneous product (i.e., a commodity) may suggest that application of RPM to contact lenses could be illegitimate.<sup>315</sup> Additionally, as previously described there are unique regulatory requirements and practices associated with the prescription and sale of contact lenses that affect competition. This suggests the potential that contact lens pricing practices may harm competition through making the potential of harmful effects from RPM more likely.<sup>316</sup> Finally, as also previously elaborated upon, despite employing a different method, the history of conflict, associated public policy, and legal actions involving contact lens manufacturers and ECPs on the one hand, and alternative distribution channels for contact lenses, on the other, provides a historical context that is consistent with the use of RPM to harm competition.<sup>317</sup>

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<sup>311</sup> Alexander (2015), 36 (Describing Johnson & Johnson's pricing practices: "The third step was to implement the unilateral pricing policy for our established products."). Alcon, B&L and CooperVision reserved introduction of their pricing practices for new products only.

<sup>312</sup> Gerber (2014), 34 (Describing that the use of UPP by contact lens manufacturers "... has the ability to support and protect brand equity.").

<sup>313</sup> Intermediaries include mega retailers like Walmart, large club stores like Costco and giant distributors like ABB Concise Optical Group. It also includes collectives of ECPs like the American Optometric Association and those represented by ABB Concise Optical.

<sup>314</sup> Alcon, B&L and CooperVision reserved introduction of their pricing practices for new products only while J&J applied their pricing practices to established products. Alexander (2015), 36 (Describing Johnson & Johnson's pricing practices: "The third step was to implement the unilateral pricing policy for our established products.").

<sup>315</sup> Atkinson (2014), 1 (Describing that "However, with the advent of disposable lenses in the 1980s, contact lenses became a commodity instead of a specialty item" and calling for amendment of the "Fairness to Contact Lens Consumers Act to allow authorized third party sellers of contact lens to give consumers a choice of lenses based on new FDA lens categorization system based on functionality, rather than brand."). Eiden & Kassalow (2014), 36 ("As frequent replacement/disposable contact lenses grew to become the predominant modality of lens wear, patients became more aware of the contact lenses that they were wearing (design, parameters, and manufacturer). They began to perceive contact lenses as a commodity rather than as a medical device utilized by their ECP to address the unique vision and physiological requirements of their eyes. As such, over time, there was a drive to place extreme price pressure on the sale of contact lenses.").

<sup>316</sup> At least two distinguishing features of the retail distribution for contact lens industry are that prescriptions for contact lenses are brand-specific and that ECPs can both prescribe and sell contact lenses. As previously described, both of these features pose implications for competition in ways that make the potential of harmful effects from RPM more likely.

<sup>317</sup> As previously described, a recurrent theme in the past conflicts found in the contact lens industry is that, in an effort to protect their profits, contact lens manufacturers and incumbent ECPs have engaged in repeated efforts to eliminate competition from new forms of retail distribution for contact lens. This was alleged to have occurred in the

**Applicability of the forestalling innovation thesis.** The most historically relevant explanation of RPM's harmful effects is that RPM results in higher retail prices through forestalling innovations in distribution that would otherwise lower costs and lead to lower prices for consumers. At least two contact lens manufacturers and one wholesaler have made public statements that suggest the forestalling innovation thesis explains their use of restrictive pricing practices. These include statements by Laura Angeline, President Johnson & Johnson; Bob Ferrigno, North American President, Cooper Vision; and Angel Alvarez, CEO of ABB Optical Group, a major contact lens wholesaler:

"[UPP] ... gives the optometrist the ability to improve his or her capture rate in the office. Now the patient has no incentive to shop around."<sup>318</sup>

"We held 12 focus groups and spoke with 100 ECPs, who felt UPP was consistent in helping them maintain their relationships with their patients."<sup>319</sup>

"Contact lens fitters have always been and will always be a focus of our organization. We do everything possible to help them succeed."<sup>320</sup>

In addition to these statements, other aspects of the industry and pricing practices of contact lens manufacturers possess characteristics that are consistent with the forestalling innovation thesis. As previously described, and as predicted by the forestalling innovation thesis, innovative and less costly channels of distribution have emerged in recent times to challenge ECPs in the distribution of contact lenses. In addition, various features of the distribution of contact lenses affect retail competition in ways that are consistent with the forestalling innovation thesis. The contact lens industry has also witnessed a long history of inter-channel conflict between incumbent and new forms of retail distribution that includes RPM and other practices known to limit innovation as described through the forestalling innovation thesis. Finally, reviews of empirical studies in other industries report that higher prices are associated with the predicted effects of the forestalling innovation thesis. Representatives of Johnson & Johnson claim that their pricing practices have led to lower prices for consumers based on their pricing studies, however, others dispute these claims and offer pricing studies showing that Johnson & Johnson's pricing practices have led to higher prices for consumers.

**Innovation in contact lens distribution.** As previously described, various channels of distribution are found in the contact lens industry. These independent ECPs and alternative forms of distribution found through commercial operations (e.g., optical chains, mass merchandisers and wholesale clubs) and most recently online retailers. Independent analyses conducted by the FTC in 2004 concluded that "[n]on-traditional contact lens sellers, such as Internet and mail order providers, represent a unique alternative distribution channel and offer some consumers a combination of price and convenience that they value highly."<sup>321</sup> Further, as found by the FTC "consumers can often achieve significant savings by purchasing replacement lenses from sellers other than their eye care providers..."<sup>322</sup> More recent analyses finds that as of 2014, non-store

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past with pharmacies and mail-order retailers and is now alleged to be the case with wholesale clubs, discount retailers, and Internet retailers. These prior conflicts provide an historical context that is consistent with the use of RPM to harm competition and also information that evidences a pattern of related conduct over time.

<sup>318</sup> VisionMonday.com (2014).

<sup>319</sup> Bob Ferrigno, Cooper Vision, statement to VMail (2014).

<sup>320</sup> Angel Alvarez, CEO ABB Optical Group, Statement to PCON (October 2014).

<sup>321</sup> FTC (2004), 12.

<sup>322</sup> FTC (2004), 13.



retailing has increased its share of sales (18.2% up from 14.5% in 2009) of sales.<sup>323</sup> Internet retailing of contact lens has grown to capture 14.9% of sales in 2014<sup>324</sup> and is forecasted to grow and account for 18% of sales by 2019.<sup>325</sup> Assessing this trend, industry observers report “Internet retailers have gained a competitive advantage over more traditional retail channels by promising cheaper prices and offering free shipping and convenient restocking.”<sup>326</sup> These observers conclude that “E-commerce channels have been successful in this field because they are able to offer convenience and have successfully marketed themselves as being the most affordable.”<sup>327</sup> Thus, drawing on their lower pricing and competitive advantage, Internet retailing channels of distribution represent a growing form of competition for traditional distribution of contact lenses through ECPs.

*Contact lens distribution and innovation.* As also previously described, various features of the retail distribution of contact lenses are unique to the contact lens industry and affect competition between retailers. These features are also consistent with the forestalling innovation thesis. As described, because prescriptions for contact lenses are brand-specific, remaining competition involves competition among retailers that sell contact lenses and competition between manufacturers for the patronage of ECPs in prescribing their brands. Given ECPs can both prescribe and sell contact lenses, ECPs are encouraged to sell contact lens. However, these ECPs face a conflict of interest when selling lenses they also prescribe (i.e., do they prescribe what’s best for the patient as a professional, or do they prescribe what’s most lucrative for the ECP as a retailer). Given their role, patients lack the specialized knowledge required to choose their own contact lenses. Consequently, they lack the individual knowledge to second-guess their ECP and rely on the ECP to prescribe the right contact lens for them. The result is that ECPs that both prescribe and sell contact lenses are also “gatekeepers” for retail competition. Given this role, these ECPs stand to profit from forestalling the price lowering effects of more innovative retailers.

*Channel conflict and innovation.* As further previously described, the contact lens industry has a long history of inter-channel conflict between incumbent and more innovative and efficient forms of retail distribution. A recurrent theme in these past conflicts is that, in an effort to protect their profits, contact lens manufacturers and incumbent ECPs engaged in repeated efforts to eliminate competition from new forms of retail distribution that could provide their patients with lower priced contact lenses. This was alleged to have occurred in the past with pharmacies and mail-order retailers and is now alleged to be the case with wholesale clubs, discount retailers, and Internet retailers. Prior independent analyses conducted by the FTC concludes that “[n]on-traditional contact lens sellers, such as Internet and mail order providers, represent a unique alternative distribution channel and offer some consumers a combination of price and convenience that they value highly.”<sup>328</sup> Further, according to the FTC “consumers can often achieve significant savings by purchasing replacement lenses from sellers other than their eye care providers...”<sup>329</sup> Thus, although involving other practices beyond RPM, these prior

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<sup>323</sup> Euromonitor International (2014), 6.

<sup>324</sup> Euromonitor International (2014), 6.

<sup>325</sup> Euromonitor International (2014), 16.

<sup>326</sup> Euromonitor International (2014), 15.

<sup>327</sup> Euromonitor International (2014), 1.

<sup>328</sup> Foer (2014), 12

<sup>329</sup> Foer (2014), 13.

conflicts provide a historical context and pattern of conduct that is consistent in form with the forestalling innovative thesis.

*Price effects and innovation.* A predicted outcome of the forestalling retail innovation thesis is that consumers will incur higher prices over time. This result occurs given retail innovation that would result in lower prices is forestalled through the price restraining effects of RPM. A recent review of prior empirical studies that have investigated the impact of RPM on reseller prices finds that RPM is generally (but not exclusively) associated with higher resale prices.<sup>330</sup> However, contrary to these predictions and studies, public statements by manufacturer Johnson & Johnson contend that based on their study, a majority, but not all, of their customers have realized lower retail prices due to their restrictive pricing practices. For example, as stated by representatives of Johnson & Johnson:

“Specifically, we estimate that about 60 percent of consumers are paying lower prices today as a result of our UPP. To be clear, we’re not saying that every consumer is paying a lower price. There are some consumers paying higher prices, but the majority of consumers are paying lower prices than they paid before.”<sup>331</sup>

“To date, approximately 58 percent of consumers have realized lower price since the launch of the unilateral pricing policy. Thus, our policy provides a lower price, solved the patients’ affordability, reduced the consumer price in the marketplace.”<sup>332</sup>

“It [their pricing practice] is one of the means by which we want to try and accomplish our goal of lowering prices, and if it doesn’t work then we’ll make an adjustment.”<sup>333</sup>

Public statements, and studies by others dispute the claims made by Johnson & Johnson concerning their contact lens prices. These include, for example, a major Internet retailer, a major wholesale club, a published ECP, and a grass-roots organization. These statements contend that Johnson & Johnson’s pricing practices have led to higher prices for consumers. For example:

“Johnson & Johnson is arguing that more customers have seen a decrease. We [1800-Contacts] disagree with that argument. But what’s being lost is that the entire opportunity to discount contact lenses has been taken from the market...”<sup>334</sup>

“Our [Lens.com] data on net cost to consumer shows that dramatic increase in cost to consumers.”<sup>335</sup>

“So our [Costco Wholesale] prices increased on some lenses up to 35 percent.”<sup>336</sup>

“Finally, [according to an ECP] the actual price mandated by UPP has so far been higher than lenses that do not have a UPP.”<sup>337</sup>

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<sup>330</sup> Gundlach, Manning & Cannon (2015).

<sup>331</sup> Eric Helms, Johnson & Johnson, Idaho Legislative Session, *House Bill 149 Hearing*, 19 (2015).

<sup>332</sup> Taketo Miura, Johnson & Johnson, Washington Legislative Session, Senate Bill 5489 7-8 (2015).

<sup>333</sup> Millicent Knight, Head of Profession Affairs Johnson and Johnson, *Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?*, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights (2014), Video 1:06:19.

<sup>334</sup> Thomas (undated).

<sup>335</sup> Cary Samourkachian, Lens.com, *Illinois House Bill 2450 Hearing*, 5 (2015).

<sup>336</sup> Denise Mogil, Costco Wholesale & Dr. Carol Alexander, Johnson & Johnson, Oregon Senate Committee On Judiciary, *Senate Bill 933 Hearing*, 8 (2015).

<sup>337</sup> Gerber (2014), 34.

“[According to Stopupp.org] Online shoppers are feeling the largest impact of UPP with price increases in every single contact lens covered by UPP, some almost tripling in price.”<sup>338</sup>

Understanding of the impact of manufacturer’s pricing practices on consumer prices is made difficult because of reported differences in the pricing studies by Johnson & Johnson and 1800-Contacts. The different results and views observed by Johnson & Johnson and 1800-Contacts are explained by 1800-contacts to be the result of differences in the sample design and unit of analysis studied by 1800-Contacts and Johnson & Johnson. Johnson & Johnson’s sample reportedly included 450 doctors selected at random and then nine months later a different sample of 450 doctors while 1800-Contacts sampled the same 749 doctors across time<sup>339</sup> as well as distribution channels other than doctors. Thus, sample variations may account for the differences in the findings. In addition, Johnson & Johnson’s unit of analysis focused on a single box of contact lenses while 1800-Contacts unit of analysis focused on an annual supply. Thus, variance in the unit of analysis studied may account for the differences in the findings.<sup>340</sup> Finally, it is the case that the prices of Alcon, Bausch & Lomb, and CooperVision reportedly could not be studied because their pricing practices applied to new products only; thereby foreclosing comparison of prices before and after introduction of their pricing practice.<sup>341</sup> Understanding of the impact of manufacturer’s pricing practices on consumer prices is also potentially confounded because, in Johnson & Johnson’s case, at the same time they established a retail price below which retailers could not sell their products they reduced their wholesale prices on affected brands (Acuvue).<sup>342</sup> It’s not clear that the wholesale price of other brands were lowered<sup>343</sup>, and other manufacturers reportedly did not lower their wholesale prices in conjunction with establishing a retail price below which retailers could not sell their products.<sup>344</sup> Understanding the effects of manufacturer’s pricing practices should include consideration of the effects of lowering the wholesale price of affected brands.<sup>345</sup> In particular, it is important to understand whether the observed price effects are the independent result of lower wholesale prices, the independent result of the RPM, or the result of the combination of both lower wholesale prices and RPM.<sup>346</sup>

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<sup>338</sup> Stopupp.org, Stop Contact Lens UPP Bringing fairness back to market (2015), <http://www.stopupp.org/>.

<sup>339</sup> MaGure (2015), 66 (“The difference was J & J’s sample was 450 doctors at a random, and then nine months later a different 450 doctors. We’ve sampled 749, the same doctor in both places.”).

<sup>340</sup> MaGure (2015), 67 (Describing differences in their study of an annual supply of contact lenses versus Johnson & Johnson’s study of a single box of contact lens: “What we would say, because of the way that product is sold, that’s an increase. Johnson & Johnson would claim it would be a decrease.”).

<sup>341</sup> MaGure (2015), 67 (“As Johnson & Johnson pointed out, the other vendors had all brought out new product so there was no historical ability to compare.”). Thomas (undated) (Describing the pricing practices of Alcon, B&L and CooperVision, “In fact, their introductions have been on new products.”).

<sup>342</sup> Alexander (2015), 35 (Describing Johnson & Johnson’s pricing practices, “First we lowered our Wholesale prices to every reseller, including 1-800 Contacts. And many are passing those savings on to consumers.”). Knight, (2014) (“First, by implementing UPP, we are lowering the price for the most widely-prescribed Acuvue brand lenses.”).

<sup>343</sup> Knight (2014), (“First, by implementing UPP, we are lowering the price for the most widely-prescribed Acuvue brand lenses.”).

<sup>344</sup> Thomas (undated), 13 (“In the case of Alcon, B&L, and CooperVision, they haven’t changed their wholesale prices with the introduction of the unilateral pricing policies.”).

<sup>345</sup> Howard P. Marvel, *Resale Price Maintenance and Resale Prices: Paying to Support Competition in the Market for Heavy Trucks*, 55 ANTITRUST BULLETIN 79 (2010) (“Expectations about the price effects of resale price maintenance (RPM) must play a central role in evaluating its impact.”).

<sup>346</sup> Samourkachian (2015), 4 (One thing we’ve noticed is that there’s a difference in their pricing. What they did was they lowered their wholesale prices. And they’re using that as claiming that UPP is lowering prices, where it’s not.

In the latter case, it is important to understand whether the lower wholesale prices and RPM are, in fact, inseparable and therefore act in combination to yield the observed price effects.<sup>347</sup> As a matter of pricing strategy, either could be implemented separately. Any study of prices at a point in time also does not consider that wholesale prices and the retail price below which retailers cannot sell a manufacturers product can change over time.<sup>348</sup> Finally, it should be noted that higher retail prices are generally consistent, in theory, with both harmful and beneficial uses of RPM.<sup>349</sup> Thus, in the absence of a determination of a particular theory's applicability, price studies may not be wholly dispositive of the welfare effects of the restrictive pricing practices of contact lens manufacturers.

## Directions for Analysis

Analyses that bear in mind the aforementioned insights should be helpful to ongoing assessments of the competitive implications of contact lens manufacturers' pricing practices. These analyses should emphasize factors identified for understanding RPM's harmful tendencies and relevant theories of RPM's harmful effects. The factors identified for understanding RPM's harmful tendencies should be individually studied applying relevant understanding and information. These analyses should include those factors identified by the Supreme Court in *Leegin* as well as other factors identified over time in the literature. These studies should be open and receptive to identifying other factors that aid in understanding any harmful tendencies on the part of contact lens pricing practices. Future analyses should also further elaborate upon the findings of the AAI and others which focus on the *Leegin* factors and rely on publically available data. Emphasis should also be given to analyses of the harmful effects of contact lens manufacturers' pricing practices. Given its historical relevance, particular focus should be given to the applicability of the forestalling innovation thesis. Focus should be given to investigating

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So they did two things. They lowered the wholesale price and they instituted UPP. So what's really happening is that the wholesale price reduction is the effect of it.”).

<sup>347</sup> Marvel (2010), 81 (Describing the price effects of resale price maintenance: “Rather than allowing its resale price to rise to reflect increased dealer margins, a supplier who adopts a policy to keep margins elevated will typically lower its wholesale price to pay for distribution services when doing so permits it to compete more effectively against its rivals.”). Howard P. Marvel, *The Welfare Effects of Resale Price Maintenance*, 28 JOURNAL OF LAW AND ECONOMICS 363 (1985) (“In an earlier paper, we demonstrate that if the cost of providing services is fixed, the retail price of the good in question will not increase. This surprising result follows from the profit-maximizing behavior of a monopolist who employs RPM to set the distributor margins and thereby controls the quantity of services offered by (competitive) retailers. With or without such control, the manufacturer will set the wholesale price such that the resulting price at retail will maximize profits, given the marginal costs of production and of distribution. If marginal costs are constant and if the service generated increase in demand does not change the elasticity of demand for the product at the previous price, the profit-maximizing retail price is unaltered. The manufacturer therefore responds to the increase in retail margins caused by the imposition of RPM by an offsetting reduction of the wholesale price.”). See further Howard P. Marvel & Stephen McCafferty, *The Political Economy of Resale Price Maintenance* (unpublished manuscript, Ohio State Univ.) (copy unavailable) (1984).

<sup>348</sup> Samourkachian (2015), 3-4 (Describing the effect of Johnson & Johnson's pricing practices: “And they can change at any time. They could change it tomorrow. So it's murky because of that ...”).

<sup>349</sup> *Leegin* (2007), 895 (Citing FTC (1983), “Respondent is mistaken in relying on pricing effects absent a further showing of anticompetitive conduct. Cf. id., at 106 (explaining that price surveys “do not necessarily tell us anything conclusive about the welfare effects of [resale price maintenance] because the results are generally consistent with both procompetitive and anticompetitive theories.”). Areeda & Hovenkamp (2009), A-27 (Analyzing the *Leegin* decision: “While Justice Breyer is correct that resale price maintenance results in higher short term prices, the majority was also correct to observe that the price observation does not address the competition question. Price might be higher but output could be higher as well, as when dealers are performing more point-of-sale services that customer value, or when the manufacturer uses costly strategies to differentiate its product in other ways.”).

the factors that support or challenge the plausibility of the thesis as a justification for manufacturers pricing practices. These analyses should focus both on the process and outcomes that accompany this thesis. Studies of the process should include consideration of unique circumstances that surround the retail distribution of contact lens given they encourage the type of conduct contemplated by the forestalling innovation thesis. Studies of the process should also include consideration of the history of the industry given it involves inter-channel conflict and practices consistent in form with the forestalling innovation thesis. Studies of the process should also examine other circumstances in the distribution of contact lens and their consistency with the theory's predictions. Studies of the outcomes predicted by the forestalling innovation thesis should include investigation of the effects of manufacturers' restrictive pricing practices on lower cost retail innovation in the industry as well as the results of such innovation in the form of lower prices to consumers. In regard to prices, future analyses may wish to further investigate the differences found in the results of the different price studies offered to explain the price effects of contact lens manufacturers' pricing practices. Finally, any price studies conducted should bear in mind differences that can result from different sampling and units of analysis, the effects of reduced wholesale prices, the potential that prices may change over time, and that higher retail prices are also consistent, in theory, with the competitive benefits of RPM.

## COMPETITIVE BENEFITS

Where it is shown or inferred that a manufacturer's use of RPM has harmful tendencies or effects for competition, the practice must be shown to serve a legitimate business function.<sup>350</sup> Numerous theoretical explanations that describe the competitive benefits of RPM have been developed over time.<sup>351</sup> These explanations are relied upon in antitrust to justify the use of RPM and related practices that restrict resale prices.

### Beneficial Effects of RPM

**The free rider thesis.** The most historically relevant explanation for RPM's beneficial effects is captured in the *free rider thesis*.<sup>352</sup> This explanation describes how RPM preserves or enhances competition through resolving externalities resulting from free riding. Free riding takes place when "when one benefits at no cost from what another has paid for."<sup>353</sup> The free riding explained to be resolved by RPM is *intra*brand free riding.

The archetype form of intra-brand free riding involves consumers shopping across retail channels in search of a manufacturer's product and "discount" dealers free riding on the presale promotional investments of "full-service" dealers.<sup>354</sup> As described by Hovenkamp:

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<sup>350</sup> Areeda & Hovenkamp (2006), ¶1633d (Describing a rule of reason analysis of RPM: "Once harmful effects or tendencies are (1) inferred from proof of adverse factors or simply presumed and (2) not rebutted ... we must consider the double relevance of legitimate objectives.").

<sup>351</sup> Gundlach, Manning & Cannon, (2015).

<sup>352</sup> Areeda & Hovenkamp (2006), ¶1619 ("The most commonly given justification for resale price maintenance is that it makes distribution more efficient by preventing free riding."). Slover (2014) ("The free rider argument is the classic argument for tolerating re tail price maintenance.").

<sup>353</sup> Chicago Professional Sports Ltd. V. NBA, 874 F. Supp. 844 (N.D. ILL. 1995).

<sup>354</sup> Herbert Hovenkamp, *Exclusive Joint Venture and Antitrust Policy*, 1 COLUMBIA BUSINESS LAW REVIEW 61 (1995).

“...the full service computer dealer may have, among other things, an expensive showroom, trained personnel demonstrating computers and assembling optimal packages, seminars for prospective purchasers. The free riding dealer down the street has a cheap warehouse, untrained minimum wage personnel, and stacks of computers in boxes.

Customers will go to the full service dealer and obtain the information they need to make a wise choice; then they will go to the free rider to make their purchase at a lower price.”<sup>355</sup>

Although consumer cross-channel shopping behavior is part of the retail shopping process, where intrabrand free riding becomes a serious concern it may pose adverse effects (i.e., externalities) that can affect the viability of a manufacturer’s distribution system. Full service dealers who are the victims of extensive free riding may become reluctant to invest in pre-sale services desired by a manufacturer. In the extreme, retailers may choose to stop carrying the manufacturer’s product all together. Thus, where free riding is a serious concern, RPM is explained to be an efficient mechanism for resolving these challenges and insuring the viability of a manufacturer’s distribution system.

RPM is explained to discourage intrabrand free riding and thereby induce retailers to invest in presale services for a manufacturer’s product.<sup>356</sup> Establishing a uniform resale price below which sales of the manufacturer’s product cannot be resold reduces incentives for price conscious consumers to engage in shopping across channels and retailers in search of a lower price for the manufacturer’s product. Setting a retail price floor high enough to compensate retailers for their efforts encourages retailers to invest and participate in the presale services desired by a manufacturer. Enforcing the resale price floor assuages retailers of concerns that, if they do invest and participate in these services, other retailers of the same product will not be able to lure customers away through only offering lower prices. Although reviews of academic and industry research on RPM<sup>357</sup> report that its use generally (but not exclusively) results in higher retail prices, RPM is said to be justified where its use alleviates the adverse results of free riding (i.e., threatens the viability of the manufacturer’s distribution system).

*Expansion beyond presale services.* Overtime, the free riding thesis has been expanded to circumstances that go beyond presale services. This includes settings where customers and discount retailers free ride on the reputational investments that signal (i.e., certify) the quality of products carried by prestige retailers.<sup>358</sup> Reputational investments include those capable of conveying and the quality of the brands carried by prestige retailers. In addition, the explanation has also been applied to explain the use of RPM in settings involving Internet retailers and brick-and-mortar retailers.<sup>359</sup> Applying the labels “showrooming” and “webrooming” to consumer free riding behavior, each class of reseller has accused the other of free riding on their investments in brand promotion.<sup>360</sup> Thus, the free rider thesis has been extended beyond free riding involving pre-sale services offered by full-service dealers, to include the reputational investments of

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<sup>355</sup> Hovenkamp (2010), 97-98.

<sup>356</sup> Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 JOURNAL OF LAW AND ECONOMICS 86 (1960).

<sup>357</sup> Hollander (1966), 68. Overstreet (1983). Gundlach, Manning & Cannon (2015).

<sup>358</sup> Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 THE RAND JOURNAL OF ECONOMICS 346 (1984).

<sup>359</sup> Marina Lao, *Resale Price Maintenance: the Internet Phenomenon and ‘Free Rider’ Issues*, 55 ANTITRUST BULLETIN 473 (2010).

<sup>360</sup> Kirithi Kalyanam & Andy A. Tsay, *Free Riding and Conflict in Hybrid Shopping Environments: Implications for Retailers, Manufacturers, and Regulators*, 58 ANTITRUST BULLETIN 19 (2013).



prestige retailers and the more general brand promotion investments of mass-merchandisers. The free rider thesis was the principal procompetitive theory discussed in *Leegin*.

*Criticisms and challenges.* Despite being the most historically relevant procompetitive explanation for RPM, the free rider thesis has been the subject of extensive criticism and challenge. Emphasis of the free rider thesis has led to its use in situations for which free riding has been argued to be trivial, if not unlikely, (e.g., boxed candy, hair shampoo, pet food, etc.).<sup>361</sup> The free rider thesis has also been suggested to have been used in situations for which commentators contend involve “clearly pretextual explanations” for RPM.<sup>362</sup> The use of RPM to address free riding has further been argued to be a productively, and therefore allocatively, inefficient choice to address free riding when considering the monitoring and enforcement resources necessary to insure retailers adhere to RPM and that the desired promotional services are actually provided. For example, according to Hollander, “[t]he direct costs of a strong enforcement program, including lawyers’ fees, court charges and shopping service expenses, can be prohibitive when the products are sold through large numbers of restless dealers.”<sup>363</sup> Many of these costs continue today despite the advent of computerized shopping services that aid in the monitoring of prices.<sup>364</sup>

Other challenges to the use of RPM to address free riding include that its use can distort, in productively and allocatively inefficient ways, retailers promotional incentives resulting in misleading and deceptive forms of presale promotion that steer consumers to purchase products that they may not otherwise be interested in purchasing.<sup>365</sup> RPM has also been explained to be productively and allocatively inefficient to the extent that its use encourages promotional services unneeded or undesired by comparatively larger groups of consumers than those that need or desire it.<sup>366</sup> RPM has also been explained to be productively and allocatively inefficient to the extent that its use encourages RPM by other manufacturers that cancel out its demand increasing effects.<sup>367</sup> Given its narrow focus on allocative efficiency, neoclassical explanations for RPM including the free rider thesis have further been criticized for failing to consider the dynamic effects of RPM on retail innovation and growth (i.e., dynamic efficiencies). Dynamic efficiencies that result in the temporal progression and growth of an economic system have been argued to be more important for advancing consumers’ interests than one-time static efficiencies that focus on the allocation of resources at a point in time.<sup>368</sup> Finally, RPM has been argued to be

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<sup>361</sup> Robert Pitofsky, *Are Retailers Who Offer Discounts Really “Knives”? The Coming Challenge to the Dr. Miles Rule*, Antitrust 61 (2007).

<sup>362</sup> Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free Riding*, 76 ANTITRUST LAW JOURNAL 431 (2009). Warren S. Grimes, *The Path Forward After Leegin: Seeking Consensus Reform of the Antitrust Law of Vertical Restraints*, 75 ANTITRUST LAW JOURNAL 467 (2008).

<sup>363</sup> Hollander (1966), 82.

<sup>364</sup> Grimes (2010), 101.

<sup>365</sup> Grimes (2010), 101.

<sup>366</sup> William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARVARD LAW REVIEW 983 (1985).

<sup>367</sup> YAMEY (1966). Brief of William S. Comanor and Frederic M. Scherer as Amicus Curiae Supporting Neither Party 9, *Leegin Creative Leather Products v. PSKS, Inc.*, 551 U.S. 877 (2007).

<sup>368</sup> Scherer & Ross (1990), 613. Deborah A. Garza et al, Antitrust Modernization Committee: Report and Recommendations, 39 (2007) (“Innovation provides a significant share of the consumer benefits associated with competition, particularly in the most dynamic industries.”). Nelson (2015) (“While one-time static efficiencies may have important effects on consumer welfare, dynamic efficiencies can be even more important.”). Kwoka (2015) (“In industries where innovation is the key competitive variable—industries such as pharmaceuticals, software, and

less efficient when compared to alternative methods (e.g., promotional allowances, display allowances, etc.) for obtaining presale promotion of a manufacturer's product that do not restrict retail price competition.<sup>369</sup>

**The incentive incompatibility thesis.** A more recent explanation for RPM involves the *incentive incompatibility thesis*.<sup>370</sup> This explanation describes how the use of RPM increases the internal efficiency of distribution arrangements through aligning incompatibilities among the incentives of manufacturers and retailers to engage in promotion of the manufacturer's product. The explanation is distinctive in that it describes how RPM induces retailers to offer promotional support for a manufacturer's product in the absence of free riding. Thus, according to the author, the explanation offers "a broadly applicable, procompetitive rationale for resale price maintenance."<sup>371</sup>

As explained by Klein, under widely occurring conditions, "retailers often gain substantially less than the manufacturer from the provision of..." manufacturer specific point-of-sale promotional services.<sup>372</sup> Consequently, manufacturers have an incentive to design distribution arrangements that compensate retailers for providing increased point-of-sale services for their products. As Klein puts it, "[t]his incentive incompatibility between the manufacturer and its retailers creates a profitable opportunity for manufacturers to design distribution arrangements where retailers are compensated for supplying increased manufacturer-specific promotional efforts."<sup>373</sup> In multi-brand retail settings, this compensation must entail a sufficient payment to cover the retailer's opportunity cost of promoting another manufacturer's product. Generally, this compensation consists of the combination of expected retailer sales of the manufacturer's products and the expected margin on those sales. Manufacturers therefore frequently use some form of restricted distribution to increase either or both retailer sales or retailer margins. However, according to Klein, in the aforementioned circumstances, a discount retailer may "disturb the manufacturer's desired retail distribution even if the discount retailer is not free riding."<sup>374</sup> This is because the price-discounting retailer reduces the sales and, therefore, the compensation received by other retailers for promoting the manufacturer's products. As a result, since retailers require a minimum expected return to display, promote or even stock a product; affected retailers will reduce the promotional efforts they devote to the manufacturer's product and in some cases drop the manufacturer's product altogether. This financially harms the manufacturer and injures consumers who are now no longer able to purchase the product. According to Klein, "[a] manufacturer's fear of reduced sales from the loss of effective retail distribution as a consequence of inadequate retailer promotion or a reduced number of retail outlets, therefore is a reasonable and common competitive business motivation for the use of resale price maintenance."<sup>375</sup> Given these effects, RPM is explained to be "an efficient element

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search--dynamic considerations take on equal or greater importance as static cost and price issues." Gundlach, Manning & Cannon, (2015).

<sup>369</sup> Grimes (2010).

<sup>370</sup> Klein (2009).

<sup>371</sup> Klein (2009), 437.

<sup>372</sup> Klein (2009), 436.

<sup>373</sup> Klein (2009), 449.

<sup>374</sup> Klein (2009), 436.

<sup>375</sup> Klein (2009), 437.

in the compensation package provided to retailers in return for supplying increased point-of-sale-promotion.”<sup>376</sup>

*Criticisms and challenges.* As with other organizational theories, the incentive incompatibility thesis adds to market-level explanations for RPM found in neoclassical economics through consideration of (inter)organizational-level design and governance. However, given the explanation focuses on the productive efficiency of a firm, the incentive incompatibility thesis is controversial and has been criticized for espousing a standard of procompetitive effect inconsistent with mainstream interpretations of antitrust.<sup>377</sup> The incentive incompatibility explanation for RPM adopts prior developed logic, first offered by Bork to advance a standard of competitive effect that equates increases in a manufacturer’s output or profits arising from improvements in productive efficiency with the best interests of consumers.<sup>378</sup> According to Klein, RPM is consistent with the interests of consumers, because “[a] manufacturer does not appear to have an economic interest in increasing retail margins unless it serves the competitive purpose of increasing the demand for its products.”<sup>379</sup> Moreover, Klein assumes that “the highly competitive nature of retailing implies that any retailer return from the provision of promotional services that is greater than retailer costs of supplying the promotional services is likely to be largely passed on to consumers as part of the competitive retailing process.”<sup>380</sup> Consequently, a manufacturer’s decision to use RPM to increase promotion for their products is a part of the “normal competitive process” that, due to long-run retail competition, results in manufacturer promotional payments ultimately benefiting consumers. In normative terms, Klein also makes the point that “the role of antitrust is not to micro regulate this competitive process” and that RPM should be evaluated “independent of any potential distribution effects across consumers that may occur.”<sup>381</sup> Together, these assertions have been interpreted to imply a standard of procompetitive effect for antitrust assessments of RPM that equates increases in an individual manufacturer’s output or profits that result from RPM, with the consumer interest.

Despite the logic offered for the “profit/output” standard of procompetitive effect that accompanies the incentive incompatibility explanation for RPM, according to Grimes the standard amounts to: “if-it-makes-money-for-the-producer, it-must-be-good” for consumers and that has “rather startling implications” for antitrust.<sup>382</sup> As pointed out by Grimes, applying the standard, a monopoly firm’s exercise of exclusionary conduct that increase the monopolist’s own output and profitability would be considered procompetitive. As Grimes observes, Klein’s standard is “fallacious” given it promotes the interests of individual competitors rather than competition as is focused upon in antitrust.<sup>383</sup> The use of RPM switches buyers from one firm to another through encouraging promotion of a manufacturer’s product resulting in a private gain for the manufacturer, but not necessarily a gain for competition or consumers. According to

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<sup>376</sup> Klein (2009), 437.

<sup>377</sup> Grimes (2010).

<sup>378</sup> Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 25 YALE LAW JOURNAL 373 (1966); Robert H. Bork, *Resale Price Maintenance*, 77 YALE LAW JOURNAL 950 (1968); ROBERT H., BORK, *THE ANTITRUST PARADOX* 295-96 (1978).

<sup>379</sup> Klein (2009), 461.

<sup>380</sup> Klein (2009), 465.

<sup>381</sup> Klein (2009), 463.

<sup>382</sup> Grimes (2010), 110, 146.

<sup>383</sup> Grimes (2010), 146-148.

Grimes, the profit/output test can be useful, but only if applied in the proper context and that is where “an increase in output or profitability is procompetitive if it occurs across the entire category in which RPM is imposed.”<sup>384</sup>

In economic terms a standard that narrowly focuses on profits and output arising from improvements in a firm’s productive efficiency is necessarily incomplete given the knowledge that productive efficiency is a minimum yet not sufficient requirement for allocative efficiency. As Rompoy points out in relation to the interplay of productive efficiency and allocative efficiency, “A market can only be allocatively efficient if it is productively efficient. However, the reverse is not always true.”<sup>385</sup> For example, a monopolist may benefit in terms of output and profit through productive efficiency, “but if the productive efficiency also entails market power that raises prices, the achievement of productive efficiency will not coincide with the achievement of allocative efficiency.”<sup>386</sup> This is so, as the author points out, because “[t]he notion of productive efficiency, unlike allocative efficiency, does not include any implications about who gets the product once it is produced or whether the good has any value. It refers only to the method by which the product is produced, marketed, and distributed.”<sup>387</sup>

In addition to the above, like its counterparts in neoclassical economics, the incentive incompatibility thesis may also be criticized for not accounting for the inefficiencies historically associated with RPM as a promotional tool. This includes that RPM pays for promotion that may or may not occur, results in difficult monitoring and enforcement issues, increases the risk of competition distorting retail promotion, potentially encourages unneeded or undesired promotion, can inspire promotion by other manufacturers that cancels out its promotion effect, and assumes that efficient retailers cannot offer effective promotional services and lower prices at the same time. The incompatibility thesis has also been criticized for failing to consider the dynamic effects of RPM including for retail innovation and growth.<sup>388</sup> Finally, although recognizing some nonprice alternatives such as limited distribution (e.g., exclusive territories, selective distribution, etc.) may be as efficient as RPM, the incentive incompatibility explanation of RPM disregards other more effective and efficient alternatives for gaining the patronage of retailers to promote a manufacturer’s product that are not as restrictive of retail price competition.

### Implications for the Current Debate

Should the pricing practices of contact lens manufacturers be found to pose adverse tendencies or effects for competition, an important further inquiry in the current debate will involve manufacturers’ justification for their pricing practices. Thus, an important question involves what competitive benefits will be found. Given the historical relevance of the free rider thesis and the contemporary popularity of the incentive incompatibility thesis, the extent to which these theories explain contact lens manufacturers’ pricing practices will likely be important areas of inquiry. According to Areeda and Hovenkamp: “To test the claim that a restraint serves a legitimate function that the law should not obstruct, we need to (1) identify the business problem allegedly served by the restraint and appraise its legitimacy, (2) appraise the seriousness of that problem and thus the magnitude of the public benefit resulting from its

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<sup>384</sup> Grimes (2010), 110-111.

<sup>385</sup> Van RomPoy (2012), 40.

<sup>386</sup> Van RomPoy (2012), 40.

<sup>387</sup> Van RomPoy (2012), 28.

<sup>388</sup> Grimes (2010).

solution, (3) consider the effectiveness of the restraints in solving that business problem, (4) and compare the restrictiveness, effectiveness, and cost to the parties of alternative solutions to that problem.”<sup>389</sup> Interestingly, somewhat similar inquiries were conducted by the FTC in their study of the contact lens industry nearly a decade ago.<sup>390</sup> Examining the ability of the free rider thesis and tenets of the incentive incompatibility thesis to explain other distribution restrictions occurring at the time, the FTC concluded, “[t]he extent to which these theories apply to limited distribution and private label strategies in the contact lens industry is unclear.”<sup>391</sup>

**Applicability of the free rider thesis.**<sup>392</sup> At least one contact lens manufacturer has made public statements that suggest the free rider thesis explains and justifies their pricing practices. According to Alcon,

“The UPP fosters the ability and willingness of [eye care professionals] to provide services by reducing the risk that other resellers, who do not invest in educating their customers about UPP products and compete only on price, will free-ride on the investments of [professionals] who do.”<sup>393</sup>

“In recent years, however, eye care professionals or ECPs have found their profit margins on the sale of contacts to be narrow. The profit margin is low because of a classic free rider problem.”<sup>394</sup>

Despite that some manufacturers and their ECPs may be concerned when patients purchase their contact lenses from other retailers, based on available data and other information, these concerns do not appear to be so widespread or to have jeopardized the viability of the ECP distribution channel for contact lenses. In addition, as a matter of theory, where ECPs are compensated (or could be) for the promotional services they provide as part of the prescribing process, their incentives for offering such services should not be threatened by a patient filling their prescription elsewhere. Finally, the different purchase occasions that attends the purchase of contact lenses (i.e., original and replenishment purchase occasions) results in complexity for applying the free rider thesis to the pricing practices of contact lens manufacturers.

**ECP concerns for free riding.** As discovered in the past by the FTC, “manufacturers may be concerned with free riding by discounters.”<sup>395</sup> According to the FTC, “for instance, if an ECP provides services to show how one lens is superior to another, patients could take this information and order the lens from a discounter that does not provide this service.”<sup>396</sup> In the current debate involving the pricing practices of contact lens manufacturers, however, manufacturers do not appear to be making widespread claims of free riding. Although mentioned by one manufacturer (Alcon), other contact lens manufacturers do not appear to claim that their

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<sup>389</sup> Areeda & Hovenkamp (2006), ¶1633d.

<sup>390</sup> Foer (2014).

<sup>391</sup> FTC (2005), 32.

<sup>392</sup> The foregoing analysis includes by reference the more general issues associated with the free rider thesis previously described. See *infra*.

<sup>393</sup> Matthew Bultman, Law360.com, *Bausch & Lomb, Alcon Challenge Utah Contact Lens Law* (2015), <http://www.law360.com/articles/643254/bausch-lomb-alcon-challenge-utah-contact-lens-law>.

<sup>394</sup> Statement of Alcon representative (quoted by Senator Klobuchar), *Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?*, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights (2014).

<sup>395</sup> FTC (2005), 32.

<sup>396</sup> FTC (2005), 32.



pricing practices are motivated or explained by the free rider thesis. To the contrary, at least one professional familiar with the industry has concluded that there is not a free riding problem in the contact lens industry. In 2014, when asked by a member of the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights of the Committee on the Judiciary “Is there is a free rider problem in the industry,” after a lengthy explanation of intrabrand free riding, Dr. Cockrell, President of the American Optometric Association, a leading professional organization that represents ECPs, testified “So, I think the answer is no.”<sup>397</sup>

*Viability of manufacturers’ distribution systems.* For the free rider thesis to apply to contact lens manufacturers’ pricing practices, the behavior must have the effect of jeopardizing the viability of the manufacturers’ distribution system through causing ECPs to forego investing in and participating in presale services to promote the manufacturer’s product. However, several factors counter against ECPs foregoing such investments and participation. First, as healthcare professionals it is unclear that restricting retail prices is needed to induce ECPs to provide the kind of services sought by manufacturers when prescribing their contact lenses. Second, based upon the number and proportion of ECPs that distribute contact lenses, and that have historically done so, the ECP channel of distribution does not appear to be threatened by patients purchasing their lenses elsewhere. Finally, given that ECPs incur significant benefits from selling contact lenses, it is difficult to reason that ECPs would make the choice going forward to not invest and participate in the distribution and promotion of the contact lenses they prescribe.

As a threshold matter, it is unclear that restricting retail prices is needed to induce ECPs to provide services and to invest in educating their customers about the products they prescribe. As healthcare professionals involved with a regulated medical device, ECPs are required to supervise and care for the proper and safe use of contact lenses on the part of their patients.<sup>398</sup> These expectations of care are high,<sup>399</sup> and ECPs are said to work to educate the public and their patients about safe use of contact lenses and possible dangers.<sup>400</sup> ECPs are also described to get excited and stimulated when new technology comes out given its good for their consumers.<sup>401</sup> Given their goal to find the most viable product to maintain their patient’s health,<sup>402</sup> according to Dr. Cockrell, President of the American Optometric Association, a leading professional organization that represents ECPs, a manufacturer’s pricing policy doesn’t make any difference in their provision of these services and care. As stated by Dr. Cockrell:

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<sup>397</sup> David Cockrell, American Optometric Association, *Pricing Policies and Competition in the Contact Lens Industry, Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?*, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights, videotape at 56:56, (2014).

<sup>398</sup> Cockrell (2014), 21 (“...it is essential to state that contact lenses have been recognized in law and regulation since the 1970 s as a medical device . A doctor ’ s supervision and care for the proper and safe use is required.”).

<sup>399</sup> Cockrell (2014), 21 (“With expectations and care implications so notably high, my colleagues and I want, and frankly insist , on the very best contact lens products to meet our patients ’ needs.”).

<sup>400</sup> Cockrell (2014), 21 (“As a national voice of 36,000 doctors of optometry, ... and tens of millions of patients we serve, we work to educate the public about the safe use of these contacts lenses as a medical device and the dangers posed by unscrupulous sellers.”).

<sup>401</sup> Knight (2014), 35 (Most doctors are really excited when new technology comes out. Its keeps us stimulated and it’s good for the consumers.”).

<sup>402</sup> Cockrell (2014), 36 (“Just as Dr. Knight said , our goal has always got to be to find the most viable product to maintain the patient ’ s eye health , regardless of how that lens is priced by the manufacturer to us or with the UPP pricing policy.”).



“At the end of the day, if the lens doesn't fit and the patient either, A, can't see, or, B, has some problem with the lens, pricing policy doesn't matter. So for us, that pricing policy doesn't make any difference for me as a private optometrist.”<sup>403</sup>

It is also the case that, despite that alternative channels have been around for some time and have increased in their proportion of sales, given the number of ECPs that distribute contact lenses and the proportion of sales they represent, the viability of distributing contact lenses through ECPs does not appear to have been threatened. Studying the channels through which manufacturers distribute their contact lenses in 2005, the FTC found that “[m]anufacturers distribute their contact lenses through a variety of channels.”<sup>404</sup> According to the FTC, “[i]ndependent ECPs, by far operate the largest number of outlets”<sup>405</sup> in the distribution of contact lenses. Independent ECPs are “optometrists and ophthalmologists who both prescribe and sell optical products.”<sup>406</sup> Further, as determined by the FTC, “[m]ost are single entities, although some have more than one outlet.”<sup>407</sup> According to the FTC, in 2003, independent ECPs occupied 22.5 thousand retail locations and in number comprised more than all other locations by channel (e.g., major chains, other chains, mass merchants, warehouse clubs and HMOs).<sup>408</sup> In concluding that ECPs distributed the largest share of contact lenses, the FTC found at the time: “..., the data generally tell the same story with regard to shares by distribution channel. Manufacturers distribute the largest share of lenses through independent ECPs and the smallest through the online/mail-order channel. Independent research confirms this result.”<sup>409</sup>

More recent analyses find that as of 2014, store based retailing (including ECPs) of contact lenses amounts to 81.8% of retail sales and non-store retailing has increased to 18.2% of sales.<sup>410</sup> This proportion of sales across channels has changed from 2009 where store based retailing amounted to 85.5% and non-store retailing amounted to 14.5% of retail sales. During this time Internet retailing of contact lens has grown to 14.9% of retail sales in 2014<sup>411</sup> and is forecasted to grow and account for 18% of sales by 2019.<sup>412</sup> Given the aforementioned number and proportion of ECPs that distribute contact lenses continues, it will be difficult to conclude that the viability of distributing contact lenses through ECPs has been threatened by alternative channels of distribution that may not offer the same services that ECPs offer.

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<sup>403</sup> Cockrell (2014), 21 (“At the end of the day, if the lens doesn't fit and the patient either, A, can't see, or, B, has some problem with the lens, pricing policy doesn't matter. So for us, that pricing policy doesn't make any difference for me as a private optometrist.”).

<sup>404</sup> FTC (2005), 8-9.

<sup>405</sup> FTC (2005), 9.

<sup>406</sup> FTC (2005), 9.

<sup>407</sup> FTC (2005), 9.

<sup>408</sup> FTC (2005), 9.

<sup>409</sup> According to the FTC (2005), 12 (“independent research confirms this result.”) Reporting on this research the FTC (2005) describes: (“Research prepared for Johnson & Johnson (Vistakon), for example, shows 48 percent of consumers from a national survey purchased their lenses from an independent ECP, followed by 30 percent from optical chains, 9 per cent from mass merchandisers, and 5 percent from mail order. The data also suggest that optical chains, general retailers, and wholesale clubs together account for between 21 and 24 percent of distribution. Further, for 2003, Jobson Research estimated that independent ECPs and all other retailers (including optical chains, wholesale clubs, and department stores) accounted for 56.3 percent and 40.8 percent of total optical sales, respectively, and that sales of contact lenses through “alternate channels” ( i.e., online or mail order) would reach \$200 million, or 10.2 percent of total contact lens sales.”).

<sup>410</sup> Euromonitor International (2014), 6.

<sup>411</sup> Euromonitor International (2014), 6.

<sup>412</sup> Euromonitor International (2014), 16.

Finally, given that ECPs earn significant benefits from the process of prescribing and selling contact lenses, from a business standpoint, it is also difficult to reason that ECPs would choose to stop carrying and selling contact lenses. As part of their professional services, ECPs examine and fit contact lenses for a median 30% of their patients.<sup>413</sup> Thus, many of their patients wear contact lenses. The prescribing process for these patients involves examining the patient's eye health and then selecting a lens that safely and comfortably corrects their vision. To not offer the contact lens that they prescribe would appear contrary with the ECP's role in this prescribing process. Refusing to carry the contact lenses they prescribe may even result in negative connotations for the ECP. ECPs also reportedly obtain a significant proportion of their overall revenues from contact lenses – estimated to be approximately 16%.<sup>414</sup> These revenues are very profitable with gross margins ranging from 37-56%.<sup>415</sup> Together these revenues and profits provide additional inducement for the continued distribution of contact lenses by ECPs. When considering that many soft contact lens patients are refitted each time they have an eye exam,<sup>416</sup> that many of these patients purchase annual supplies,<sup>417</sup> and that many of these same patients also purchase eyeglasses;<sup>418</sup> the impact of these revenues and profits are even further significant. Finally, the proportion of revenue from the sale of contact lenses has been estimated to be growing at a faster rate than overall revenues, indicating that sales of contact lenses is of increasing importance to many ECPs.<sup>419</sup>

*Patient payments for promotional services.* It is also the case that ECPs are reportedly compensated for the presale services they provide as part of the prescribing process and through patient examination fees and fitting fees. Thus, ECPs incentives for offering promotional services should not be threatened where a patient fills their prescription elsewhere. As Areeda and Hovenkamp observe “... there is nothing upon which other dealers can free-ride when consumers must pay a dealer separately for each service it provides.”<sup>420</sup> Consequently, the

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<sup>413</sup> Management & Business Academy, Key Metrics: Assessing Optometric Practice Performance 31 (2013) (“A median of 30% of active patients in independent optometric practices wear contact lenses either full-time or part-time.”).

<sup>414</sup> Management & Business Academy (2013), 30 (“Contact lens materials generated 16% of the total gross revenue in the average independent optometric practice, with little variation by practice size.”). Management & Business Academy (2013), 14 (As of 2103, “Independent optometric practices derive 39% of revenue from professional fees and 61% from product sales, including 43% from eyewear and 16% from contact lens sales. Average revenue mix has changed little over six years of measurement.”).

<sup>415</sup> Management & Business Academy (2013), 34 (“The median gross profit margin from sales of soft lenses is 46% among independent ECPs. The range in gross profit margin is fairly narrow with 60% of practices achieving margins in the 37-56% range.”).

<sup>416</sup> Management & Business Academy (2013), 30 (“A median of 30% of soft lens patients having an eye exam are refitted with a new brand, material or lens type during their eye exam visit.”).

<sup>417</sup> Management & Business Academy (2013), 30 (“MBA practices report that a median of 25% of their soft lens patients purchasing two-week lenses purchase an annual supply of lenses during their eye exam visit. Monthly soft lens patients are more than twice as likely to purchase an annual supply, presumably because the number of boxes purchased is just four and not eight. Few daily disposable wearers purchase an annual supply.”).

<sup>418</sup> Management & Business Academy (2013), 37 (“Independent practice ODs estimate that a median of 25% of contact lens wearers purchase a pair of eyeglasses during their exam visit. Nearly all contact lens patients wear eyeglasses during a normal week and need a pair in their current prescription.”).

<sup>419</sup> Management & Business Academy (2013), 14 (“Based on VisionWatch, industry audits and MBA surveys, it is estimated that revenue from medical eye care and contact lens sales during 2012 grew at a faster rate than overall revenue among independent OD practices.”).

<sup>420</sup> Areeda & Hovenkamp (2006), ¶1602.

incentives for ECPs to invest and offer presale promotional services to their patients, and the viability of the manufacturer's distribution system, are not threatened where a patient decides to have their prescription filled elsewhere.

The above points were succinctly made by the nonprofit AAI, in their letter to both the FTC and DOJ concerning allegations of RPM in the contact lens market. As determined by the AAI:

“There is no plausible free rider argument. Contact lens wearers pay providers a separate fee for the contact lens fitting where presale promotion occurs, on top of the fee for the eye exam. In other words, eye care providers are compensated for their services and cannot suffer from free riding.”<sup>421</sup>

As concluded by the AAI, together with the payment for their eye examination, the payment by consumers of a separate fee for fitting their contact lens likely compensates ECPs for their services. Therefore, ECPs incentives for offering those services are not threatened where consumers purchase their lenses elsewhere.

As a part of their prescription rendering process, ECPs reportedly charge patients for an eye examination and charge for fitting their patients with the medically correct contact lens. The fees comprise 39% of ECPs revenues.<sup>422</sup> In return, consumers receive a prescription that specifies the size of contact lens and the particular lens (including manufacturer's brand) best suited to their needs.<sup>423</sup> When filling their prescription, the patient must purchase the identified size and brand of contact lens prescribed by the ECP. Under this arrangement, ECPs are able to charge for presale services they perform on behalf of a particular manufacturer's brand. Where they do (or could) charge for such services, ECPs are (or could be) compensated for the services they provide irrespective of whether the patient chooses to fill their prescription through the ECP or if the patient decides to have their prescription filled from another source. Consequently, despite that a patient may benefit from brand specific presale services offered by a prescribing ECP as part of the contact lens examination and fitting process and then subsequently decide to purchase their contact lens from a lower-cost retailer that does not offer the same services, this behavior does not threaten the viability of the manufacturer's distribution system involving ECPs.

The above conclusions are consistent with comments by Dr. David Cockrell, President of the American Optometric Association, a leading professional organization representing ECPs. In 2014, in addition to testifying before the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights of the Committee on the Judiciary that free riding was not a problem in the contact lens industry, when asked if the reason for this was “because you're [the ECP] being paid a fee for a service that's a separate service,” Dr. Cockrell testified, “By the patient, you mean? Correct.”<sup>424</sup>

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<sup>421</sup> Foer (2014), 5.

<sup>422</sup> Management & Business Academy (2013), 14 (As of 2103, “Independent optometric practices derive 39% of revenue from professional fees and 61% from product sales, including 43% from eyewear and 16% from contact lens sales. Average revenue mix has changed little over six years of measurement.”).

<sup>423</sup> Kathryn Richdale, Lynn Mitchell & Karla Zadnik, *Comparison of Multifocal and Monovision Soft Contact Lens Corrections in Patients With Low-Astigmatic Presbyopia*, 83 OPTOMETRY AND VISION SCIENCE 266 (2006) (“The final lens prescription was determined as it would be in a normal clinical setting, by the best overall vision, the patient's most comfortable working distance, and the patient's choice to bias the vision toward distance or near if equal acuity could not be achieved.”).

<sup>424</sup> Cockrell (2014), videotape at 57.30 – 57.34.

The above conclusion is further consistent with that reached by the FTC in their 2005 study of competition in the contact lens industry.<sup>425</sup> Examining the applicability of free rider thesis to the role of nonprice practices that limited distribution and private label strategies in the contact lens industry at the time, the FTC concluded that:

“... ECPs are likely able to recoup at least part of the cost of promotional services as part of the contact lens fitting fee. If the examination fee provides ECPs with adequate compensation for providing promotional services, this payment may ameliorate any divergence between manufacturers’ and retailers’ incentives to provide these services. Further, even if ECPs cannot recoup the cost of providing promotion services from consumers, contact lens manufacturers may be able to compensate ECPs directly. For example a manufacturer could supply ECPs with education on the attributes and proper fitting techniques related to a lens.”<sup>426</sup>

According to the FTC, “[w]ithout empirical evidence on the extent to which ECPs are compensated for promotional services through exam fees directly or indirectly from the manufacturer, however, it is impossible to determine the role limited distribution or private label strategies play in determining an ECP’s promotional effort.”<sup>427</sup>

To the extent that ECPs are (or could be) compensated for the promotional services they render when examining a patient or fitting the patient with contact lenses, it will be difficult for contact lens manufacturers to contend that the free rider thesis justifies their pricing practices. Even where patients decide to purchase their lenses from another source, to the extent ECPs are compensated for their services through examination and fitting fees, the ECPs’ incentives to offer promotional services are not threatened and the viability of the manufacturer’s distribution through ECPs is not jeopardized.

*Patient purchase occasion effects.* Finally, the above assessments that challenge the applicability of the free rider thesis do not include consideration of the complexity that accompanies the different occasions that may attend the purchase of contact lenses. In practice, consumers typically purchase a supply of contact lens that does not cover the entire length of their prescription period.<sup>428</sup> This results in their need to make a second purchase of contact lens, and possibly a third, prior to the expiration of their prescription. Where these purchases are all made from the ECP that prescribes their lenses, intrabrand free riding is not possible. However, to the extent later purchases are made from an alternative source, a patient’s decision to make their subsequent purchases elsewhere may be argued to involve free riding. However, to make this argument it is necessary to contend that an ECP’s provision of sales promotion during the

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<sup>425</sup> FTC (2005).

<sup>426</sup> FTC (2005), 33.

<sup>427</sup> The explanation by the FTC (2005), 33 does not appear to differentiate between the “examination fee” commonly charged by ECPs and the additional fee reportedly also now charged to patient’s in the form of a “fitting fee.” It is therefore unclear if the FTC was differentiating between these two fees at the time of their 2005 report or if fitting fees are a more recent phenomenon. Regardless, in either case, the two fees represent payments to ECPs by consumers from which ECPs may recoup the cost of promotional services they provide.

<sup>428</sup> FTC (2005), 5. Independent research also supports this conclusion. As reported by the FTC (2005), ft 18 (“June 2004, surveyed ECPs reported that after the exam 64 % of patients purchased a six-month supply, 20% purchased a year’s supply, and 6% purchased a three-month supply. FTN Midwest Research Securities Corp., Monthly Contact Lens Industry Survey, at 10 (2004) (“FTN Contact Lens Survey”). Research prepared for Johnson & Johnson (Vistakon) also suggests that consumers purchase less than a year’s supply of contact lenses, showing that only 12% of consumers from a national survey purchased a year’s supply at once, whereas 31% purchased lenses two times a year, and 43% purchased 3 - 4 times a year. 1-800 Contacts, Comment #1, at Attach. 2, App. 4, p.89.”).

prescribing process applies not only to the patient's original purchase of contact lenses, but to all subsequent (i.e., second, third, etc.) purchases during the prescription period. Given the different purchase occasions involved, this may be a difficult argument to assert.

Marketers have long understood that consumers may purchase the same item for different reasons, including different occasions.<sup>429</sup> Occasion segmentation recognizes that, depending on the situation, customers may use products in different ways.<sup>430</sup> Consequently, marketers utilize "occasion segmentation" to identify these occasions and create marketing programs that appeal to consumers depending on the particular use and occasion.<sup>431</sup> Occasion segmentation involves "dividing the market into groups on the basis of the different occasions when the buyers plan to buy the product."<sup>432</sup> Given differences in purchase occasions, marketers utilize different marketing approaches for each occasion.<sup>433</sup> Consequently, to the extent these differences are present the sales promotion offered for one purchase occasion may not apply and be used for another purchase occasion.

Under the FCLCA, a standard contact lens prescription typically must last for at least one year. However, according to the FTC "consumers usually purchase less than a year's supply at a time – with six month supply serving as the most popular quantity."<sup>434</sup> Thus, as concluded by the FTC, in most cases, "contact lens consumers purchase replacement lenses at least twice during the length of their prescription."<sup>435</sup> This translates to at least two purchase occasions for contact lenses following the lenses being initially prescribed. The first purchase involves the patient's "original" purchase of contact lenses (from either the ECP or another provider) and the second and subsequent purchase(s) involves the patient's "refill" purchase(s).

Given the different purchase occasions that can accompany the purchase of contact lenses, it may be difficult to contend that free riding occurs where a patient makes their refill purchase(s) from a retailer that they did not make their original purchase from. To do so requires

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<sup>429</sup> GRAEME DRUMMOND, INTRODUCTION TO MARKETING CONCEPTS 89 (2005) ("Consumer groups can be further identified on the basis of purchase occasion, i.e. when they buy a particular product or service.").

<sup>430</sup> ADRIAN PAYNE, HANDBOOK OF CUSTOMER RELATIONSHIP MANAGEMENT 68 (2005) ("Occasion segmentation recognizes that customers may use a product or brand in different ways depending on the situation.").

<sup>431</sup> SCOTT DACKO, THE ADVANCED DICTIONARY OF MARKETING: PUTTING THEORY TO USE 464 (2004) ("Occasion segmentation – dividing a market into groups based on situational factors or contingencies driving purchase and consumption."). GARY ARMSTRONG, STEWART ADAM, SARA DENIZE & PHILIP KOTLER, PRINCIPLES OF MARKETING 180 (2014) ("Occasion segmentation. Dividing the market into segments according to occasions.").

<sup>432</sup> Radhikachittoor.wordpress.com, *Understanding Occasion Segmentation and Benefit Segmentation* (2012), <https://radhikachittoor.wordpress.com/2012/03/27/understanding-occasion-segmentation-and-benefit-segmentation>. K.S. CHANDRASEKAR, MARKETING MANAGEMENT: TEXT & CASES 68 (2010) ("This segmentation divides customers on the basis of the reasons behind their purchase.").

<sup>433</sup> Pietro Berni, Diego Begalli & Roberta Capitello, *An Occasion-Based Segmentation Approach to the Wine Market in Denmark*, 17 JOURNAL OF INTERNATIONAL FOOD & AGRIBUSINESS MARKETING 117(2008) ("If on the one hand the multi-dimensional nature of the consumer as a subjective and behavioural variable relative to consumption occasions does not permit the identification of unequivocal models for specific consumer groups, it is on the other hand possible to see common elements between some consumption occasions that may also be useful in terms of marketing strategies.").

<sup>434</sup> FTC (2005), 5. Independent research also supports this conclusion. As reported by the FTC (2005), ft 18 ("June 2004, surveyed ECPs reported that after the exam 64 % of patients purchased a six-month supply, 20% purchased a year's supply, and 6% purchased a three-month supply. FTN Midwest Research Securities Corp., Monthly Contact Lens Industry Survey, at 10 (June 15, 2004) ("FTN Contact Lens Survey"). Research prepared for Johnson & Johnson (Vistakon) also suggests that consumers purchase less than a year's supply of contact lenses, showing that only 12% of consumers from a national survey purchased a year's supply at once, whereas 31% purchased lenses two times a year, and 43% purchased 3 - 4 times a year. 1-800 Contacts, Comment #1, at Attach. 2, App. 4, p.89.").

<sup>435</sup> FTC (2005), 5.

demonstrating that the benefits from retail sales promotion for the original purchase, not only applies to the patient's original purchase, but also to the refill purchase. This requires distinguishing the effects of promotional services that attend each purchase and then showing that promotion in the first purchase also affects subsequent purchases. It further requires demonstrating that free riding "across" purchase occasions jeopardizes the viability of the manufacturer's distribution system through threatening the original retailer's incentives to offer promotional services. The complexity of mounting these arguments reveals the challenges of extending the free rider thesis to circumstances involving different purchase occasions (original and refill) including the typical purchase pattern for contact lenses.

**Applicability of the incentive incompatibility thesis.** Rather than the historically relevant free rider thesis, some manufacturers have made public statements that suggest the incentive incompatibility thesis explains and justifies their pricing practices. This more general explanation describes how RPM may be relied upon to induce retailers to engage in promotion of a manufacturer's product absent free riding. These include statements by Alcon and Johnson & Johnson:

"Alcon's limited unilateral pricing policy was put into place to encourage eye care professionals to discuss new technology contact lenses with their patients. The policy helps create an environment in which eye care professionals are more likely to invest time learning about innovative contact lens technologies and educating patients about new options. Online sellers and mass merchandise stores do not make this same time investment and are able to underprice eye care professionals on contact lenses. If eye care professionals must reduce contact lens prices to compete against online sellers and other discounters, they may be less likely to continue to educate patients about new technology contact lenses as a viable option for vision correction."<sup>436</sup>

"[UPP] is a holistic multifaceted pricing policy to refocus the conversation between the doctor and the patient on eye health and product performance rather than price."<sup>437</sup>

To the extent that contact lens manufacturers do rely upon the incentive incompatibility thesis to explain and justify their pricing practices, as previously described, the explanation is controversial and has been criticized for (1) espousing a standard of procompetitive effect that is inconsistent with mainstream interpretations of antitrust; (2) failing to offer a comprehensive explanation of RPM's competitive effects; and (3) overlooking other more effective and efficient, yet less restrictive, methods for gaining the patronage of retailers in promoting a manufacturer's products.<sup>438</sup> In addition, each of the previously described analyses regarding the applicability of the free rider thesis based on (1) the viability of the manufacturers distribution system, (2) payments for promotional services, and (3) the role of purchase occasions also applies to the incentive incompatibility thesis. Beyond these concerns, additional aspects of the sale and purchase arrangements for contact lenses frustrate application of the incentive incompatibility thesis to the pricing practices of contact lens manufacturers.

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<sup>436</sup> Silverstein (2015). Alcon Laboratories, Inc., *Pricing Policies and Competition in the Contact Lens Industry: Is What You See What You Get?*, U.S. Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights (July 30, 2014) (Explaining Alcon's reasoning for their pricing policy "Rather, it was Alcon's response to the concern that inadequate margins for ECPs would lead to inadequate education of patients about the DAILIES TOTAL1® treatment option, preventing Alcon from recouping its huge financial investment in this new product.").

<sup>437</sup> Vision Monday (2014) (quoting Laura, Angelini, Johnson & Johnson).

<sup>438</sup> Grimes.



*(Non)Brand-specific promotion effect.* An essential requirement of the incentive incompatibility thesis is that the promotional services involved be specific to a particular manufacturer (i.e., brand-specific). That is, the promotional services induced through RPM involve retailer efforts to increase the sale of a particular manufacturer's products. However, some of the promotional outcomes identified by contact lens manufacturers from their pricing practices do not appear to meet this requirement.

According to Klein, the first of "three important economic characteristics" associated with the point-of-sale promotional services that are the focus of the incentive incompatibility thesis, is that "the promotional services are brand-specific."<sup>439</sup> This type of promotional services involves retail efforts "devoted solely to a particular manufacturer's products"<sup>440</sup> and "retailer efforts to increase the sale of a particular manufacturer's products."<sup>441</sup> These types of promotional services include a salesperson effort's to convince a customer to purchase a particular brand.<sup>442</sup>

Brand specific promotional services are essential to the incentive incompatibility thesis because manufacturers benefit from the incremental sales of their products they induce.<sup>443</sup> However, because manufacturers typically profit more than the retailers that offer them, "retailers often gain substantially less than the manufacturer from the provision of such services."<sup>444</sup> According to Klein, this disparity in incentives is the incentive incompatibility between the manufacturer and its retailers that "creates a profitable opportunity for manufacturers to design distribution arrangements whereby retailers are compensated for supplying increase manufacturer-specific promotional efforts."<sup>445</sup> In turn, RPM is theorized to be an efficient mechanism for aligning a retailer's incentives with those of the manufacturer.

Although the incentive incompatibility thesis requires that retailer promotional services induced by RPM be brand-specific, not all promotional services offered by retailers are devoted to increasing the sale of a particular manufacturer's products.<sup>446</sup> For example, non-brand-specific retailer services identified by Klein include "a knowledgeable and accessible sales staff, fast checkout, and other retailer-supplied amenities."<sup>447</sup> Many retailer promotional services are not brand-specific in nature.<sup>448</sup> In each case, these retail promotional services are not brand-specific because their provision by a retailer also increases sales of other manufacturer's products.<sup>449</sup>

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<sup>439</sup> Klein (2009), 443.

<sup>440</sup> Klein (2009), 443.

<sup>441</sup> Klein (2009), 443.

<sup>442</sup> Klein (2009), 442.

<sup>443</sup> Klein (2009), 436.

<sup>444</sup> Klein (2009), 442.

<sup>445</sup> Klein (2009), 436.

<sup>446</sup> Shun Yin Lam, Mark Vandenbosch, John Hulland & Michael Pearce, *Evaluating Promotions in Shopping Environments: Decomposing Sales Response into Attraction, Conversion, and Spending Effects*, 20 *MARKETING SCIENCE* 194 (2001) ("Retailers' marketing objectives can be classified into three broad categories: attraction effects that focus on consumers' store-entry decisions, conversion effects that relate to consumers' decisions about whether or not to make a purchase at a store they are visiting, and spending effects that represent both dollar value and composition of their transactions.").

<sup>447</sup> Klein (2009), 443.

<sup>448</sup> Yuping Liu-Thompkins & Leona Tam, *Not All Repeat Customers Are the Same: Designing Effective Cross-Selling Promotion on the Basis of Attitudinal Loyalty and Habit*, 77 *JOURNAL OF MARKETING* 21 (2013) ("Because the purpose of the promotion was to bring customers inside the store, the management considered it of greater interest to determine whether the promotion achieved this goal than to sell the specific promoted item"). Liyuan Wei & Junji Xiao, *Are Points like Money? An Empirical Investigation of Reward Promotion Effectiveness for Multicategory Retailers*, 26 *MARKETING LETTERS* 99 (2015) ("Point-based frequency reward programs are widely

Contrary to the requirement of the incentive incompatibility thesis that retailer promotional services be brand-specific, examination of the promotional outcomes identified to be the product of contact lens manufacturers' pricing practices do not appear limited to increasing the sales of a particular manufacturer's products, or are only partially so. For example, the sales benefits of efforts to "create an environment in which eye care professions are more likely to invest time learning about innovative contact lens technologies and educating patients about new options"<sup>450</sup> is not likely to be limited to a particular manufacturer's products but will apply to all manufacturer's products. As well, the benefits of making "pricing simpler and more transparent" in ways that "allow consumers to make purchasing decisions based on quality, clinical need and cost" is not likely to be limited to sales of a particular manufacturer's products. Similarly, "refocus[ing] the conversation between the doctor and the patient on eye health and product performance rather than price," do not appear to be exclusively brand specific.<sup>451</sup> Finally, statements by manufacturers and statements by related parties appear to suggest that some of the promotional services desired by manufacturers are "channel-specific" rather than brand-specific. For example statements by Bob Ferrigno, North American President, Cooper Vision; Laura Angeline, President Johnson & Johnson; and Angel Alvarez, CEO of ABB Optical Group, a major contact lens wholesaler, appear to suggest that the pricing practices of manufacturers are intended to benefit the ECP channel over alternative channels of distribution:

"ABB has been working closely with manufacturers to develop unilateral pricing policies, which we believe enable a better overall patient experience by supporting the competitiveness of prescribing practitioners, ... Contact lens fitters have always been and will always be a focus of our organization. We do everything possible to help them succeed."<sup>452</sup>

"[UPP] ... gives the optometrist the ability to improve his or her capture rate in the office. Now the patient has no incentive to shop around."<sup>453</sup>

"We held 12 focus groups and spoke with 100 ECPs, who felt UPP was consistent in helping them maintain their relationships with their patients."<sup>454</sup>

To the extent the outcomes sought are not brand-specific, it will be difficult for contact lens manufacturers to contend that their pricing practices are explained by the incentive incompatibility thesis.

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used by retailers as a sales promotion strategy. To promote a specific product category, retailers offer more favorable reward ratios so that members can earn extra points.").

<sup>449</sup> Rockney G. Walters, *Assessing the Impact of Retail Price Promotions on Product Substitution, Complementary Purchase, and Interstore Sales Displacement*, 55 JOURNAL OF MARKETING 17 (1991) ("Promotions on one brand may stimulate sales of brands that must be used with the promoted brand to yield another distinct product, as in the case of strict complements, or the promotions may stimulate sales of a related brand because together the brands serve a specific consumer need. Complementary relationships between brands are reflected in everyday practice as retailers carefully select the array of products they promote in an effort to stimulate sales of nonpromoted full-margin complements.").

<sup>450</sup> Silverstein (2015).

<sup>451</sup> Tim Bowden & Tony Harknett, *Contact lens wearer profile 2004*, 28 CONTACT LENS AND ANTERIOR EYE 37 (2005) ("The brand name of the original lens fitted is listed as 'unknown' in 77% of cases and 61% for the current lenses. This is not surprising considering the time interval in many cases. Responses to this question seemed similar between the sexes but varied across age groups. This result was similar to our previous studies. The brands listed for current lenses were Johnson & Johnson 16.3%, CIBAVision 11.3%, CooperVision 3.5%, Bausch and Lomb 2.6% and Ocular Sciences 2.4%. Smaller makers and own brands accounted for 2.9%.").

<sup>452</sup> Alvarez (2014).

<sup>453</sup> Vision Monday (2014) (quoting Laura Angelini, Johnson & Johnson).

<sup>454</sup> Ferrigno (2014).

*Buying participants phenomenon.* Because patients rely on their ECPs to select a contact lens for them, there are also questions about the demand inducing role of the promotional services prompted by contact lens manufacturers' pricing practices. A second requirement of the incentive incompatibility thesis is that the promotion induced be of the kind that influences incremental sales of a manufacturer's product (i.e., brand). However, in the case of contact lenses, where a patient relies on an ECP to select a contact lens for them, promotion directed at patients may fail to meet this requirement. Consequently, the incentive incompatibility thesis may not apply, or only partially so, to the pricing practices of contact lens manufacturers.

In addition to a particular type of promotion, the incentive incompatibility thesis focuses on a particular form of demand. The contemplated demand involves incremental consumer demand (i.e., sales) for a manufacturer's product.<sup>455</sup> As described by Klein, one of the three important economic characteristics associated with the promotion focused on by the incentive incompatibility thesis, is that "manufacturer-specific promotional services supplied by retailers are primarily aimed at 'marginal consumers' who, absent the promotion, would not purchase the manufacturer's product at current prices, but may do so when the manufacturer-specific promotional services are supplied."<sup>456</sup> Despite this requirement, as observed by the FTC, when consumers purchase contact lens they must rely upon their ECPs to select a lens for them.<sup>457</sup> Thus, promotion by contact lens manufacturers that is directed at patients may not engender the demand effects required for the incentive incompatibility thesis to apply.

In their study of competition in the contact lens industry, the FTC reports that, with respect to consumer demand for contact lenses:

"consumers ... lack the specialized knowledge necessary to determine which lens is appropriate for them. Thus, consumers must rely on an ECP to select a lens that safely and comfortably corrects their vision."<sup>458</sup>

As found by the FTC, "although advertising and other forms of information may help to educate consumers, ECPs likely possess more information concerning the relative quality of a particular lens."<sup>459</sup> Although some "consumers may possess sufficient knowledge about contact lens brands to ask their prescribing ECP for a specific, widely available brand"<sup>460</sup> and "advertisements for national brands of lenses are commonplace," (FTC 2005, p. 21) according to the FTC "ECPs ... control the prescription process,"<sup>461</sup> and for the aforementioned reasons, "[p]atients want their ECPs to prescribe for them a contact lens that represents their preferred combination of price and quality" (FTC 2005, p. 16).

Independent healthcare research offers further support to the decision role played by ECPs in selecting contact lenses for their patients. This research finds that despite that some

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<sup>455</sup> Klein (2009), 441-2 ("consumer demand for some products is related to the pre-sale promotional services supplied by retailers" and one form of promotional services that "induces incremental sales is brand-specific point-of-sale salesperson promotional efforts.").

<sup>456</sup> Klein (2009), 443.

<sup>457</sup> FTC (2005), 16 ("Thus, consumers must rely on an ECP to select a lens that safely and comfortably corrects their vision.").

<sup>458</sup> FTC (2005), 16.

<sup>459</sup> FTC (2005), 16.

<sup>460</sup> FTC (2005), 21-22.

<sup>461</sup> FTC (2005), 6. FTC (2004), 1 ("While eye care providers still control the prescription process, consumers now not only purchase more lenses with greater frequency but they also have a greater choice of lens suppliers and modes of delivery.").

patients report a desire for more information from their primary healthcare physicians<sup>462</sup> and from their ECPs<sup>463</sup> “... client requirements for further information do not always arise from the desire to take a more active role in the decision-making process.”<sup>464</sup> Instead, as has been concluded in more than one study, ECPs “underestimated the importance of their own recommendations on purchasing decisions”<sup>465</sup> and “overestimate the extent to which clients feel able, or are interested in contributing to the lens decision making process.”<sup>466</sup> Moreover, of the factors reported to influence purchase decisions, by far the most important factor reported by patients was their optician’s recommendations (reported by 70% of patient respondents).<sup>467</sup> In various studies a large number,<sup>468</sup> if not “most clients, report that they do not discuss the relative benefits of different lens options with their practitioner”<sup>469</sup> but instead that they accept the recommendation made.”<sup>470</sup> Moreover, “the majority of participants (88%) believed that following their optician’s recommendations would provide them with the best possible eyesight...”<sup>471</sup> Relatedly, contact lens patients report following their ECPs recommendation for eye care products 93% of the time.<sup>472</sup> As concluded by one team of researchers:

“While shared medical decision-making is becoming more widely used in the medical environment, there is also an increasing recognition that clients vary in the extent to which they prefer themselves or their clinician to make major decisions.”<sup>473</sup>

Because “there is [also] evidence that within primary care ophthalmology clinics, patients may not have the knowledge required to make decisions regard their eye care,” these researchers counsel that practitioners should be sensitive to client’s preferences and tailor their information and its communication appropriately.<sup>474</sup>

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<sup>462</sup> Sarah Ford, Theo Schofield & Tony Hope, *Are Patients’ Decision-Making Preferences Being Met?*, 6 HEALTH EXPECT 72 (2003).

<sup>463</sup> Aerlyn G. Dawn, Cecilia Santiago-Turla & Paul P. Lee, *Patient Expectations Regarding Eye Care—Focus Group Results*, 121 ARCH OPHTHALMOL 762 (2003).

<sup>464</sup> Fiona Fylan & Elizabeth A. Grunfeld, *Visual illusions? Beliefs and Behaviours of Presbyope Clients in Optometric Practice*, 56 PATIENT EDUCATION AND COUNSELING 291 (2005). Citing E. Guadagnol & P. Ward, *Patient Participation in Decision-Making*, 47 Soc Sci Med 329 (1998).

<sup>465</sup> Fylan (2005), abstract.

<sup>466</sup> Fylan (2005), 294. Dawn, Santiago-Turla & Lee (2003), 762 (“In general, participants expressed few expectations for specific actions to be taken by the ophthalmologist. Our results are compatible with previous research findings that clinic employees, physicians, and administrators underestimate patient expectations for empathy but consistently overestimate expectations for tangible actions.”).

<sup>467</sup> Fylan (2005), 293 (In contrast, “practitioners reported their own recommendations were perceived to be important by only 16% of the practitioner sample.”).

<sup>468</sup> Ford, Schofield & Hope (2003), 72 (“In 46% of all consultations, patients reported that decisions were made by the doctor alone.”).

<sup>469</sup> Yvonne Wu, Nicole Carnt & Fiona Stapleton, *Contact Lens User Profile, Attitudes and Level of Compliance to Lens Care*, 33 CONTACT LENS AND ANTERIOR EYE 183 (2010) (“When participants were asked to specify how often they were advised to return for an aftercare visit, 51% reported that they could not remember or that no advice was given regarding their aftercare schedule.”).

<sup>470</sup> Fylan (2005), 295.

<sup>471</sup> Fylan (2005), 294.

<sup>472</sup> Thai H. Bu, H. Dwight Cavanagh & Danielle M. Robertson, *Patient Compliance During Contact Lense Wear: Perceptions, Awareness, and Behavior*, 36 EYE & CONTACT LENS 334 (2010) (“When queried about choice of care products, 93% of patients reported using the recommended solution.”).

<sup>473</sup> Fiona Fylan & Elizabeth A. Grunfeld, *Four Different Types of Client Attitudes Towards Purchasing Spectacles in Optometric Practice*, 8 HEALTH EXPECTATIONS 18, 19 (2005).

<sup>474</sup> Fylan (2005), 20.

Consistent with the findings of the FTC and the aforementioned research, at least one contact lens seller previously found it necessary to take steps to encourage consumers to ask their prescribing ECP for a specific brand. For example, according to the FTC, 1-800 Contacts previously provided the following information on its Web site: “If you are interested in wearing a different contact lens, one available any place you chose to shop, you might consider requesting a prescription for a different brand during your next exam.”<sup>475</sup> Similarly, in apparent recognition of the decision role of ECPs in selecting a contact lens for their patients, another manufacturer reports at the time to have primarily directed their promotion at ECPs versus consumers. Describing the marketing efforts of manufacturer Ocular Sciences (OSI), the FTC determined that: “OSI uses very little consumer advertising and promotion. OSI primarily promotes its contacts to eye care professionals and affiliated chains, and relies on these retailers to promote its products to consumers.”<sup>476</sup>

From a marketing perspective, what these sellers understand, and what the FTC and independent research has found, is that many purchases, including contact lenses, involve multiple participants rather than a single decision-maker.<sup>477</sup> Further, that where multiple participants are involved in a purchase, the party that decides on the product to be purchased is not always the party that actually buys and uses the product.<sup>478</sup> Marketers have identified this “buying participant” phenomenon and extensively studied its effects in practice.<sup>479</sup> A key finding is that where multiple participants are involved in a purchase each may play a different role in the process.<sup>480</sup> The marketing literature identifies these roles to include the “initiator,” “influencer,” “decider,” “buyer” and “user.”<sup>481</sup> The buying participant phenomenon has been shown to apply to complex<sup>482</sup> and higher value<sup>483</sup> purchases.<sup>484</sup> Where multiple buying

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<sup>475</sup> FTC (2005), footnote 67.

<sup>476</sup> FTC (2005), 32.

<sup>477</sup> Charles W. McMonnies, *Improving Patient Education and Attitudes Toward Compliance with Instructions for Contact Lens Use*, 34 CONTACT LENS AND ANTERIOR EYE 241 (2011) (“For example, people are more easily persuaded by individuals perceived to be legitimate authorities and belief in their advice increases accordingly. Any practitioner’s authority may be undermined (contradicted) by a patient’s friends or acquaintances, perhaps especially those who have been wearing contact lenses for years and have contrived less expensive and/or less time consuming non-compliant ways of handling their lenses.”).

<sup>478</sup> KUNJINISH VASHISHT, A PRACTICAL APPROACH TO MARKETING MANAGEMENT 82 (2005) (“A buyer is the person who actually buys the product. A buyer may or may not be a decider.”). LOUIS BOONE & DAVID KURTZ, CONTEMPORARY MARKETING 191 (2013) (“Users are the people who will actually use the good or service. Their influence on the purchase decision may range from negligible to extremely important.”).

<sup>479</sup> RAY WRIGHT, CONSUMER BEHAVIOUR 18 (2006) (“It needs to be understood that any one buying situation could involve many different people, all ultimately able to influence the final purchase.”). KAPIL, SHARMA, MARKETING MANAGEMENT: HOW TO CREATE, WIN AND DOMINATE MARKETS 71 (2009) (“While the purchasing process in the consumer market is not as complex as the business market, having multiple people involved in a purchase decision is not unusual.”).

<sup>480</sup> FELINA C. YOUNG & CRISTOBAL M. PAGOSO, PRINCIPLES OF MARKETING 91 (2008) (“In any buying process, consumers personify specific roles in deciding what product to purchase, when and where to purchase, how often or how frequent to buy, and how much to pay for a certain product. A number of different types of persons may be involved in the buying process...”).

<sup>481</sup> M. S. RAJU & DOMINIQUE XARDEL, MARKETING MANAGEMENT 54 (2009) (“Although many buying decisions involve only one decision-maker, some decisions may involve several participants who play such roles as initiator, influencer, decider, buyer, and user.”).

<sup>482</sup> S. JAYACHANDRAN, MARKETING MANAGEMENT 298 (2004) (“The more complex the purchases, the more likely that several persons will participate in the decision making process.”).

<sup>483</sup> TIM J. SMITH, HAWKS, SEAGULLS, AND MICE: PARADIGMS FOR SYSTEMATICALLY GROWING REVENUE IN BUSINESS MARKETS 78 (2006) (“Multiple people contribute to the purchase decision when the product or service is

participants are present, the marketer's job is to identify the participants, their respective roles, and then design their marketing programs accordingly.<sup>485</sup>

Given the buying participant phenomenon and its apparent effects in the purchase of contact lens, it may be difficult for contact lens manufacturers to contend that the incentive incompatibility thesis explains their pricing practices. To do so requires that the patient-directed promotional services induced by manufacturers' pricing practices influence incremental demand for their products. However, because ECPs control the prescribing process and patients rely on an ECP to select their contact lens, promotion aimed at patients may not result in this required increase in demand. For example, promotion by ECPs arising from Alcon's pricing practices and intended to "educate patients about new technology contact lens"<sup>486</sup> or by Johnson & Johnson that informs patients about the "quality, clinical need and cost"<sup>487</sup> of contact lenses may be informative to patients and may even affirm their ECPs selection. However, acting as "deciders" ECPs select contact lenses for their patients. Thus, it is unclear to what extent patients use information they receive about contact lenses to influence their ECP's selection during the prescribing process. Given that some sellers have found it necessary to take steps to encourage patients to request of their ECPs a prescription for a different brand, suggests this may not happen very often. That another seller previously decided to use very little consumer advertising and promotion, but instead engage in promotion directed primarily at ECPs, bolsters this inference. Finally, it may also be the case that attempting to induce patients to influence their ECPs contact lens selection is not medically desirable. If, as found by the FTC, patient's lack the specialized knowledge necessary to determine which lens is appropriate for them, a patient's influence of their ECP could lead to the unintended consequence of a medically inappropriate choice of contact lenses for them.

*Services characteristic effect.* Even if the patient-directed-ECP-delivered promotional efforts of contact lens manufacturers work to influence incremental demand for their products, the incentive incompatibility thesis faces additional challenges as an explanation for the pricing practices of contact lens manufacturers. Another requirement of the thesis is that, in influencing incremental demand through manufacturer specific point-of-purchase promotion, there are no "spillover" effects that affect inter-retailer demand (i.e., demand associated with where consumers shop). To the extent these effects occur and are significant, retailers profit from engaging in the promotion and are motivated to do so. Consequently, the contemplated incompatibility in incentives between the manufacturer and retailer toward supplying the promotion does not exist and the thesis does not apply. Extended to the contact lens industry, where manufacturer-specific point-of-sale promotion by an ECP also affects the demand for the

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of high value .... Each of these individuals has different concerns and different sets of priorities."). BRUCE DAVID KEILLOR & VIJAY R. KANNAN, *INTERNATIONAL BUSINESS IN THE 21<sup>ST</sup> CENTURY*, 257 (2011) ("If a person is purchasing a product or service for the first time, they will be cautious and seek enough information to support their purchase decision. They will look for guidance from multiple people they trust.").

<sup>484</sup> Smith (2006), 78 ("Multiple people contribute to the purchase decision when the product or service is of high value .... Each of these individuals has different concerns and different sets of priorities."). Keillor & Kannan (2011), 257 ("If a person is purchasing a product or service for the first time, they will be cautious and seek enough information to support their purchase decision. They will look for guidance from multiple people they trust.").

<sup>485</sup> Raju (2009), 54 ("Although many buying decisions involve only one decision-maker, some decisions may involve several participants who play such roles as initiator, influencer, decider, buyer, and user. The marketer's job is to identify the other buying participants, their buying criteria, and their influence on the buyer.").

<sup>486</sup> Silverstein (2015).

<sup>487</sup> Silverstein (2015).



ECP relative to another ECP, the ECP profits from engaging in the promotion and will be motivated to offer it. To the extent this occurs, the incompatibility in incentives between manufacturers and ECPs contemplated by the thesis does not exist and therefore the thesis does not apply.

As described by Klein, an important characteristic of the promotional services focused on by the incentive incompatibility thesis is “that retailer supply of such services is unlikely to have significant inter-retailer demand effects.”<sup>488</sup> The absence of inter-retailer demand effects implies that the profits earned by a manufacturer from point-of-sale promotional services often will be substantially greater than the profits earned by the retailer.<sup>489</sup> Thus, according to Klein, the absence of inter-retailer demand effects, is “[t]he fundamental economic reasons manufacturers find it necessary to encourage retailer to supply more manufacturer-specific point-of-sale promotional services.”<sup>490</sup> The profit differential creates the incompatibility in incentives that is at the core of the incentive incompatibility thesis. However, where inter-retailer demand effects do result from the provision of manufacturer-specific point-of-sale promotional services, they affect where consumers shop. Given retailers can profit from the provision of these services, retailers are motivated to provide them and manufacturers will not find it necessary to encourage retailers to supply them.

Despite the requirement that there be no significant inter-retailer demand effects associated with the promotional services offered by retailers for the incentive incompatibility thesis to apply, in many settings promotional services do give rise to inter-retailer effects. This is because, in the evaluation and consumption of services, consumers find it difficult to separate the services provided from the provider of those services. Known to marketers as the “intangibility of services”<sup>491</sup> and “inseparability of services”<sup>492</sup> this effect stems from the lack of tangibility of services<sup>493</sup> and the simultaneous production and consumption of services.<sup>494</sup> Contrary to goods

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<sup>488</sup> Klein (2009), 443-444.

<sup>489</sup> Klein (2009), 444.

<sup>490</sup> Klein (2009), 444.

<sup>491</sup> Gordon H. G. McDougall & Douglas W. Snetsinger, *The Intangibility of Services: Measurement and Competitive Perspectives*, 4 JOURNAL OF SERVICES MARKETING 27 (1990) (“It has been argued that intangibility, the lack of physical evidence, is the critical product-service distinction from which all other differences emerge. For example, in a review of the service marketing literature, (in)tangibility was always mentioned as one of the unique characteristics of services”). HARSH V. VERMA, SERVICES MARKETING: TEXT AND CASES 38 (2012) (“Services are intangible offerings which cannot be touched, smelled, seen on [sic] tasted. They are activities or performances executed by the provider.”). CHRISTINE ENNEW & NIGEL WAITE, FINANCIAL SERVICES MARKETING 178 (2007) (“... the intangibility of services means that the process by which the service is provided will often be an important influence on the consumers’ assessment of service quality.”).

<sup>492</sup> S. H. H. KAZMI, MARKETING MANAGEMENT: TEXT AND CASES 592 (2007) (“Inseparability of services refers to the fact that service production and consumption cannot be separated. Both, the production and consumption of services take place simultaneously.”). K. HOFFMAN & JOHN BATESON, SERVICES MARKETING: CONCEPTS, STRATEGIES & CASES 63 (2011) (“Inseparability reflects the interconnection between the service provider, the customer involved in receiving the service, and other customers sharing in the same service experience.”). MARKUS VENZIN, BUILDING AN INTERNATIONAL FINANCIAL SERVICES FIRM: HOW SUCCESSFUL FIRMS DESIGN AND EXECUTE CROSS-BORDER STRATEGIES 43 (2009) (“Inseparability of services means that services are often produced and consumed at the same time, as and when required by the customer.”).

<sup>493</sup> Hoffman (2011), 64 (“Because of the intangibility of services, the service provider becomes a tangible clue on which at least part of the customer’s evaluation of the service experience becomes based.”).

<sup>494</sup> GARY ARMSTRONG, STEWART ADAM, SARA DENIZE & PHILIP KOTLER, PRINCIPLES OF MARKETING 218 (2015) (“Service inseparability means that services cannot be separated from their providers, whether the providers are people or machines. If a service employee provides the service, then the employee becomes part of the service.”).

that are tangible and therefore can be separately produced, stored, and then later consumed, services are intangible and therefore cannot be stored but must be simultaneously produced by the service provider and consumed by the service consumer.<sup>495</sup> As a consequence of these characteristics, consumers find it difficult to distinguish the service provider from the services that are provided to them.<sup>496</sup> These characteristics of services are well-known and understood to apply to all types of services.<sup>497</sup>

Submissions by ECP's and reported by the FTC in their study of competition in the contact lens contacts industry suggest that the intangibility and inseparability of services characteristic and its effects are present with respect to promotional services provided by ECPs that offer them.<sup>498</sup> For example, relative to the promotional role of brands carried by an ECP (a form of promotion) and the ECP's reputation and credibility, the FTC reports that, "... consumers want national brands and *carrying such brands lends prestige to a practice (emphasis added)*."<sup>499</sup> As reported by the FTC, according to one ECP, "I feel it gives me more credibility to have a nationally recognized contact lens armamentarium."<sup>500</sup> These same effects likely extend to other services offered by ECPs in promotion of a manufacturer's brand. For example, "invest[ing] time learning about innovative ... technologies and educating patients about new options;"<sup>501</sup> and communicating the "quality, clinical need and cost"<sup>502</sup> of a patient's prescription is likely to affect patient's perceptions of their ECP. Such activities are what commonly differentiate medical professionals like ECPs from one another. Similarly, helping to "refocus the conversation between the doctor and the patient on eye health and product performance rather

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Venzin (2009), 43 ("Inseparability of services means that services are often produced and consumed at the same time, as and when required by the customer. As such, buyer-seller interaction is quite high...").

<sup>495</sup> PHILLIP KOTLER, SUZAN BURTON, KENNETH DEANS, LINEN BROWN & GARY, ARMSTRONG, *MARKETING* 292 (2013) ("Service inseparability means that services cannot be separated from their providers/producer, whether the providers are people or machines. A hair salon employee both provides the service and is a part of the service – that is, we cannot separate production of the haircut from consumption of the haircut.").

<sup>496</sup> Hoffman, 64 (2011) ("Because of the intangibility of services, the service provider becomes a tangible clue on which at least part of the customer's evaluation of the service experience becomes based."). ARMSTRONG (2015), 218 ("Service inseparability means that services cannot be separated from their providers, whether the providers are people or machines. If a service employee provides the service, then the employee becomes part of the service."). DON HOSSLER & BOB BONTRAGER, *HANDBOOK OF STRATEGIC ENROLLMENT MANAGEMENT* 107 (2015) ("Inseparability means that the quality of the service is only as good as the person who delivers it."). RICHARD T. WATSON, *ELECTRONIC COMMERCE: THE STRATEGIC PERSPECTIVE* 85 (2011) ("The main problem that intangibility creates for services marketers is that they have nothing to show the customer. Thus, experience and credence qualities are significantly important in the case of services.").

<sup>497</sup> K. HOFFMAN & JOHN BATESON, *SERVICES MARKETING: CONCEPTS, STRATEGIES, & CASES* 58 (2010) ("As a result of the intangibility of services, a number of marketing challenges arise that are not normally faced when marketing tangible goods."). AUDREY GILMORE, *SERVICES MARKETING & MANAGEMENT* 10 (2003) ("The intangibility of services makes them very different from the traditional product mix that is frequently analysed [sic] in terms of tangible design properties."). BERT ROSENBLOOM, *MARKETING CHANNELS* 497 (2011) ("These differences stem from several generally recognizable characteristics that distinguish them from products. These are (1) the intangibility of services, (2) the inseparability of services from the service providers....").

<sup>498</sup> FTC (2005), 22.

<sup>499</sup> FTC (2005), 22. T. Van Vuuren, M. Roberts-Lombard & E. Van Tonder, *Customer Satisfaction, Trust and Commitment as Predictors of Customer Loyalty Within an Optometric Practice Environment*, 16 *SOUTHERN AFRICAN BUSINESS REVIEW* 81 (2013) ("Accordingly, when a customer trusts a business or a brand, that customer is willing to form a positive buying intention towards the business.").

<sup>500</sup> FTC (2005), footnote 68.

<sup>501</sup> Silverstein (2015).

<sup>502</sup> Silverstein (2015).

than price,”<sup>503</sup> is likely to have the same result. Statements that the pricing policies of manufacturers help ECPs to “maintain their relationships with their patients,”<sup>504</sup> and “enable a better overall patient experience by supporting the competitiveness of prescribing practitioners,”<sup>505</sup> more directly suggest this outcome.

Given the inseparability of services and its effects in the purchase of contact lens, it may be difficult for contact lens manufacturers to contend that the incentive incompatibility thesis explains their pricing practices. To do so requires that the promotional services induced by manufacturers’ pricing practices not spillover and have significant effects for inter-ECP demand. However, because these promotional services are simultaneously offered by an ECP and consumed by their patient, they will likely affect patients’ views of their ECP and result in inter-ECP effects. To the extent these effects are significant, ECPs profit from engaging in the promotional services and will be motivated to do so. Consequently, the contemplated incompatibility in incentives between contact lens manufacturers and their ECPs does not exist and the thesis does not apply.

*Effects of consumer differences.* Finally, the incentive incompatibility thesis faces challenges as an explanation for the pricing practices of contact lens manufacturers because it fails to acknowledge differences among customers regarding their desire for retail promotion.<sup>506</sup> As formulated, the incentive incompatibility thesis assumes that, when making a purchase, all customers stand to benefit from the promotion induced by RPM. However, despite that when making a purchase some customers may benefit from retail promotion, other customers may purchase a product without the need or desire for such promotion. If customers that don’t benefit from retail promotion pay a higher purchase price because of RPM, they are harmed by a manufacturers use of RPM (i.e., they pay higher prices without receiving any benefits from the promotion). Where there are sufficient numbers of these customers, the harms caused by them paying for unwanted promotion may exceed the benefits for other customers. Consequently the welfare effects predicted by the incentive incompatibility thesis depend on the relative distribution of customers in a market. The potential that contact lens patients differ in their need or desire for retail promotion prospectively challenges the overall positive welfare effects predicted for RPM by the incentive incompatibility thesis.

First recognized by economist William Comanor, “The conventional [RPM] wisdom fails to acknowledge the importance of differences among consumers regarding their preferences for dealer-provided services.”<sup>507</sup> These differences involve the nature of demand held by the so-called “marginal” and “infra-marginal” consumers identified previously. As explained by the author, “the marginal consumer is one whose valuation of a product approximates its current price and who is therefore relatively sensitive to any product improvement that may disturb the rough equilibrium between subjective valuation and market price.”<sup>508</sup> These consumers stand to

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<sup>503</sup> Vision Monday (2014) (quoting Laura, Angelini, Johnson & Johnson).

<sup>504</sup> Ferrigno (2014).

<sup>505</sup> Alvarez (2014).

<sup>506</sup> This failure also applies to the positive welfare effects predicted for RPM by the free rider thesis.

<sup>507</sup> William S. Comanor, *Vertical Price-fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARVARD LAW REVIEW 983, 990 (1984).

<sup>508</sup> Comanor (1984), 991 (“The marginal consumer is one whose valuation of the product approximates its current price, and who is therefore relatively sensitive to any product improvement that may disturb the rough equilibrium between subjective valuation and market price. If the amount that a marginal consumer is willing to pay for higher

benefit from retail promotion about a product and are willing to pay for its promotion.<sup>509</sup> Alternately, infra-marginal consumers “place a value on the original product substantially higher than the original price” and therefore are relatively insensitive to any product improvement in the form of retail promotion and will not buy more or less of a product as a result.<sup>510</sup> These consumers do not stand to benefit from retail promotion and do not wish to pay for promotion.<sup>511</sup> According to the author “Many of the consumers in this class may be previous customers who originally learned about the product through outside sources or from advertising provided directly by the manufacturer.”<sup>512</sup>

Differences among marginal and infra-marginal consumers potentially frustrate the positive welfare effects predicted by the incentive incompatibility thesis for RPM. According to Klein, “because dedicated point-of-sale promotional services manufacturers purchase from retailers with increased retail margins are not demanded by all consumers, some consumers are better off but other consumers [are] worse off as a result of the manufacturer’s actions.”<sup>513</sup> In more particular terms:

“Specifically, while marginal consumers who increase their purchases of the manufacturer’s products value and, hence, benefit from the increased promotional services paid for with resale price maintenance, infra-marginal consumers who would have purchased the manufacturer’s products in any event are worse off since they are paying higher prices without receiving any benefit from the retailer’s increased promotional service.”<sup>514</sup>

The consequence of the above is that the net welfare effect of manufacturer-specific retailer promotion induced by RPM depends on the relative number of infra-marginal and marginal consumers that purchase a manufacturer’s product.<sup>515</sup> As described by Comanor, where the number of infra-marginal consumers is great, “the harm caused by making them pay for unwanted services may exceed the benefit derived by marginal consumers.” Under these conditions, the promotional services are oversupplied in relation to the consumer optimum.<sup>516</sup>

In relation to the incentive incompatibility thesis, Klein acknowledges that “...there are likely to be distribution effects across consumers when a manufacturer uses resale price maintenance to compensate retailers for dedicated promotional efforts.”<sup>517</sup> However, according to Klein, “this is a normal consequence of competition” and “the role of antitrust is not to micro-regulate this competitive process by calculating whether a particular marketing practice in a particular circumstance produces a net welfare gain or not.”<sup>518</sup> Moreover, in Klein’s view, “it is highly unlikely that a court could empirically estimate these differential effects between marginal

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quality even slightly exceeds the accompanying increase in price, he will generally buy more of the product. Similarly, if he does not find the improvements worth the price increase, he will generally purchase less.”).

<sup>509</sup> Comanor (1984), 992.

<sup>510</sup> Comanor (1984), 991 (“Some -- call them “infra-marginal consumers” -- place a value on the original product substantially higher than the original price. Such consumers are therefore relatively insensitive to any price increase needed to fund a change in product quality. Even if, according to their valuations, the improvement does not warrant the additional cost, they will not buy less of the product as a result.”).

<sup>511</sup> Comanor (1984), 992.

<sup>512</sup> Comanor (1984), 992.

<sup>513</sup> Klein (2009), 62.

<sup>514</sup> Klein (2009), 462.

<sup>515</sup> Klein (2009), 462 (2009).

<sup>516</sup> Comanor (1984), 992.

<sup>517</sup> Klein (2009), 463.

<sup>518</sup> Klein (2009), 463.

and infra-marginal consumers and accurately determine when total consumer welfare was or was not reduced.”<sup>519</sup>

Extended to the purchase of contact lenses, the potential that patients differ in their purchase requirements, and therefore the benefits they obtain from retail promotion, potentially undermines the positive welfare effects predicted for RPM by the incentive incompatibility thesis. Following Comanor, if the number of patients that don’t benefit from retail promotion is great, the harm caused by making them pay for unwanted services resulting from contact lens manufacturers pricing practices may exceed the benefit derived by patients that benefit from the promotion. Under these conditions, promotional services induced by the pricing practices of contact lens manufacturers may be oversupplied in relation to the consumer optimum. In short, if a group of consumers benefit slightly from RPM, but a significantly larger group of patients are harmed by RPM and to a much larger extent, RPM acts in aggregate to oversupply promotional services.

Research and other evidence suggests that patients differ in their requirements for information conveyed during the purchase of optical products<sup>520</sup> and that ECPs recognize these differences and tailor their information accordingly. As already described, patients likely differ in their need for information depending on the purchase occasion and by virtue of the buying participants phenomenon.<sup>521</sup> For these and related reasons research reports that there is an “increasing recognition that, as part of patient-centered care, [optometric] consultations should be tailored to the individual needs of clients.”<sup>522</sup> This recognition reflects the conclusion that patients “have different requirements with respect to the desired outcome of the consultation; the amount of information required from the practitioner<sup>523</sup>; and the amount of client input to treatment decision making.”<sup>524</sup> Consequently, researchers have advised practitioners to “tailor information to meet the needs and address the expectations of individual clients.”<sup>525</sup> For their part, practitioners report “tailoring information to match the needs of individual clients”<sup>526</sup> based upon differences in occupation, age and perceptions of client needs and other factors.<sup>527</sup>

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<sup>519</sup> Klein (2009), 463.

<sup>520</sup> T.J. Bowden, A. Harknett & I. Forrest, *Contact Lens Wearer Profile*, 26 *Contact Lens Anterior Eye* 37 (2002) (“This survey shows some significant shifts from our previous surveys. This may be due to the broader data base produced from such a wide range of practices and locations, however, it does perhaps illustrate the need for the eyecare professional to consider the changing needs of our patients.”).

<sup>521</sup> Juliette G. M. M. Hoevenaars, Jan S. A. G. Schouten, Bart van de Borne, Henny J. M. Beckers & Carroll A. B. Webers, *Socioeconomic Differences in Glaucoma Patient’s Knowledge, Need for Information and Expectations of Treatments*, 84 *ACTA OPHTHALMOLOGICA SCANDINAVICA* 84 (2006) (“Concerning the need for information, great differences exist between the low and high socioeconomic groups, as well as between the middle and high socioeconomic groups.”).

<sup>522</sup> Fylan (2005), 18.

<sup>523</sup> Ugur Yavas, Martin Benkenstein & Michael Holtz, *Satisfaction with Optometric Services in Germany: A Dyadic Perspective*, 27 *SERVICES MARKETING QUARTERLY* 35 (2006) (“Optometrists are under a false impression; while customers are satisfied with the services they receive, store owners/managers tend to think that the services they provide fall short of customer expectations. Any resources directed at addressing the situation would not have a high payoff. Only small marginal increases of customer satisfaction can be obtained by adding resources to these areas. These factors should receive low priority.”).

<sup>524</sup> Fylan (2005), 291.

<sup>525</sup> Fylan (2005), 18.

<sup>526</sup> Fylan (2005), 294.

<sup>527</sup> Fylan (2005), 294-295.

Recognizing these differences, according to researchers, “may make the information provided more personally relevant and could enhance client satisfaction.”<sup>528</sup>

That differences exist in the attitudes and beliefs held by patients toward information and retail promotion should not be surprising given they reflect the widespread understanding that consumers differ in their needs and wants.<sup>529</sup> These differences serve as the basis for much of competitive decision making by firms.<sup>530</sup> Literature in marketing and related fields focuses on understanding these differences and their implications for marketing decisions.<sup>531</sup> This literature supports the proposition that consumers vary in their preferences, including for information when making purchase decisions.<sup>532</sup> It also offers evidence that marketers commonly engage in activities to tailor their offerings, including promotional services, to these differences.<sup>533</sup> To the extent this variation and these activities accompany the purchase of contact lenses they challenge the net positive welfare effects predicted for the pricing practices of contact lens manufacturers by the incentive incompatibility thesis.

**Applicability of other explanations for RPM.** Additional public statements and actions by contact lens manufacturers suggest (or at least imply) that less known theories of RPM may be relied upon to explain and justify their pricing practices. These include explanations for RPM that describe its use to facilitate the introduction of new products and explanations for RPM that describe its use to eliminate the adverse effects theorized to result from practices that confuse and mislead consumers and/or denigrate a manufacturer’s brand reputation.

**The new product thesis.** Statements made by Alcon and the actions of other manufacturers suggest that they may attempt to justify their pricing practices based upon their ability to facilitate the introduction of new products. According to Alcon:

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<sup>528</sup> Flyan (2005), 18.

<sup>529</sup> James Burrow & Aubrey Fowler, *Marketing* 126 (2015) (“Most businesses recognize that consumers have very different needs and wants and likely view product and service choices quite differently.”).

<sup>530</sup> Peter R. Dickson & James L. Ginter, *Market Segmentation, Product Differentiation, and Marketing Strategy*, 51 *JOURNAL OF MARKETING* 1 (1987) (“Markets have been segmented and products and services differentiated for as long as suppliers have differed in their methods of competing for trade. The major advance in recent times has been that market researchers are using economic and behavioral theories and sophisticated analytical techniques in their search for better ways of identifying market segments and product differentiation opportunities.”).

<sup>531</sup> MICHAEL JOHN BAKER, PETER GRAHAM & DEBRA HARKER, *MARKETING: MANAGERIAL FOUNDATIONS* 164 (1998) (“All consumers are unique. The differences among consumers (for example, age, income, needs and preferences) make a standardized product or service unacceptable. Market offerings must be tailored specifically to the needs of each individual consumer.”).

<sup>532</sup> PETER CARTWRIGHT, BANKS, *CONSUMERS AND REGULATIONS* 239 (2004) (“What this division reveals is that consumers have needs for very different types of information, and that different consumers will have very different needs at different times.”). PHILIP J. KITCHEN, *MARKETING COMMUNICATIONS: PRINCIPLES AND PRACTICE* 64 (1999) (“...the whole communications flow needs to be organized around the fact that consumers are no longer dependent on the manufacturer to supply information. Consumers will request information as needed or desired, and will make their purchase decisions at places and times convenient to *them*.”).

<sup>533</sup> See textbooks and research on “integrated marketing communications.” American Marketing Association, (2015) (The American Marketing Association defines “Integrated marketing communications” as “a planning process designed to assure that all brand contacts received by a customer or prospect for a product, service, or organization are relevant to that person and consistent over time.”), <https://www.ama.org/resources/Pages/Dictionary.aspx?dLetter=I>).



“Alcon’s limited unilateral pricing policy applies only to new and innovative brands of contact lenses and was introduced to encourage eye care professionals to educate their patients about the benefits of these breakthrough technologies.”<sup>534</sup>

“Alcon remains committed to applying its UPP only to new, and breakthrough lens technologies”<sup>535</sup>

With the exception of Johnson & Johnson, other contact lens manufacturers have introduced their restrictive pricing practices on new products. For example, when Bausch & Lomb adopted its restrictive pricing policy, it did on a new product (i.e., Ultra). When CooperVision adopted a restrictive pricing policy, it did on a brand it acquired (i.e., Calriti) that had previously been introduced with such a policy. However, when Johnson & Johnson adopted its restrictive pricing policy it did on an existing product line (i.e., Acuvue). Statements by Alcon and the actions of Bausch & Lomb and CooperVision (but not Johnson & Johnson) may be interpreted to invoke explanations for RPM that describe its use to introduce new products.

The new product thesis for RPM has been described by scholars over time and was recognized by the Supreme Court in *Leegin*. According to Areeda and Hovenkamp, “resale price maintenance might facilitate new entry by inducing dealers to risk the investment necessary to develop the market” for a new product.<sup>536</sup> Similarly, Elzinga and Mills describe that “[t]o secure entry, a new entrant may seek to gain retail distribution by offering independent retailers protection against discounting, in the hope that margin protection will induce retailers to market and promote the new product.”<sup>537</sup> Finally, as observed by Hylton, “...minimum resale price maintenance, by reducing intrabrand competition through price cutting, promotes interbrand competition that in turn encourages entry and innovation by manufacturers.”<sup>538</sup> In *Leegin*, the Supreme Court recognized that, “[r]esale price maintenance, ... can increase interbrand competition by facilitating market entry for new firms and brands.”<sup>539</sup> According to the Court, “[n]ew manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor

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<sup>534</sup> Alcon Unilateral Pricing Policy (2015), <http://www.alcon.com/news-center/unilateral-pricing.aspx>.

<sup>535</sup> Alcon.com (2015). Eiden & Kassalow (2014), 36 (citing a Alcon Unilateral Price Policy Customer FAQ Document, June 1, 2013 and stating “Alcon states that the policy will benefit patients and help ensure that the company can continue to innovate and bring state-of-the-art products to market in the future.”).

<sup>536</sup> Areeda & Hovenkamp (2006), ¶1631b (Describing the theory: “A manufacturer unwilling or unable to distribute a new product itself needs dealers. Suppose that establishing the dealerships requires a substantial investment, not only in facilities but also in advertising, demonstration, and other market development beyond that which the manufacturer itself provides. Suppose further that the prospective dealers believe these investments cannot be recovered without a period of substantial profit after their efforts to develop demand have borne fruit. Once the market is developed, unfettered competition from newly appointed dealers can force prices down to then-existing costs, which do not include the earlier expenditures to develop demand. If prospective pioneering dealers for a new product foresee that such post-development prices would not compensate them for their earlier costs, they will refuse to embark upon distribution of that product unless they believe that manufacturer will shield them from intrabrand competition long enough for them to recover their pioneering costs. Unless the manufacturer is allowed to do so, the market will fail to bring forth the new product. Restraining intrabrand competition in these circumstances produces distribution valued by consumers.”).

<sup>537</sup> Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, 3 ISSUES IN COMPETITION LAW AND POLICY 1841, 1848 (ABA Section of Antitrust Law 2008).

<sup>538</sup> Keith N. Hylton, *ANTITRUST LAW AND ECONOMICS* (2010)

<sup>539</sup> *Leegin* (2007), 637.

that is often required in the distribution of products unknown to the consumer.”<sup>540</sup> As the Court points out, “New products and new brands are essential to a dynamic economy, and if markets can be penetrated by using resale price maintenance there is a procompetitive effect.”<sup>541</sup> Finally, citing Areeda and Hovenkamp, the Court observes that “[b]y assuring the initial dealers that such later price competition will not occur, resale price maintenance can encourage them to carry the new product, thereby helping the new producer succeed. The result might be increased competition at the producer level, i.e., greater inter-brand competition, that brings with it net consumer benefits.”<sup>542</sup>

Despite that “facilitating entry seems to be a procompetitive objective,” as pointed out by Areeda and Hovenkamp, the new product theory “does not justify every distribution restraint and never justifies a permanent one.”<sup>543</sup> According to the authors, limitations on the number of new retailers within a territory (i.e., territory restrictions) or class of customer (i.e., customer restrictions) are more suitable for encouraging new entry than is retail maintenance.<sup>544</sup> This is true for several reasons. *First*, “[p]rice restraints do not guarantee the pioneering dealer that the price the manufacturer specifies later will be based on the pioneer’s own earlier, unrecovered costs of developing the market” (i.e., *the price problem*).<sup>545</sup> *Second*, price restraints do not “prevent the manufacturer from appointing other dealers who will divert sales from the pioneer before it has recovered that investment” (i.e., *the diversion problem*).<sup>546</sup> *Third*, “[a] prospective pioneer is unlikely to be reassured by the prospect of future resale price maintenance if it fears that the manufacturer will ‘double cross’ it by allowing intrabrand competition as soon as feasible and before the pioneer recoups its initial investment” (*the double cross problem*).<sup>547</sup> Consequently, according to Areeda and Hovenkamp, issues inherent to the use of RPM to facilitate the entry and development of new products favor the use of nonprice restraints for such purposes.

Because of its association with other theories, the ability of the new product thesis to explain RPM is also limited by the criticisms and challenges identified for the free rider and the incentive incompatibility theories of RPM. Given the similarities of each theory’s underlying explanatory mechanism, the new product theory may be contrasted with the free rider theory.<sup>548</sup> Both explain the use of RPM in circumstances where one group of retailers incurs promotional expenses that are not incurred by other retailers. The new product theory extends the free rider explanation to circumstances where promotional expenditures for developing demand for a new product incurred by retailers that first carry a new product (i.e., market development expenses) are not incurred by retailers that later carry the product once demand has been developed.<sup>549</sup> In

<sup>540</sup> Leegin (2007), 637 (citing *GTE Sylvania*, 97 S. Ct. 2549, 53 L. Ed. 2d 568 and “*Marvel & McCafferty* 349 (noting that reliance on a retailer’s reputation ‘will decline as the manufacturer’s brand becomes better known, so that [resale price maintenance] may be particularly important as a competitive device for new entrants’”).

<sup>541</sup> Leegin (2007), 637.

<sup>542</sup> Leegin (2007), 651.

<sup>543</sup> Areeda & Hovenkamp (2006), ¶1617a2.

<sup>544</sup> Areeda & Hovenkamp (2006), ¶1617a3.

<sup>545</sup> Areeda & Hovenkamp (2006), ¶1617a3.

<sup>546</sup> Areeda & Hovenkamp (2006), ¶1617a3.

<sup>547</sup> Areeda & Hovenkamp (2006), ¶1617a3.

<sup>548</sup> Areeda & Hovenkamp (2006), ¶1617a2 (“This situation can be contrasted with the more usual free-rider situation. If pioneer dealers are numerous, free riding might impair even initial promotional efforts, but aside from any free-rider problem, restraints might be necessary to compensate pioneer dealers for market development costs.”).

<sup>549</sup> Areeda & Hovenkamp (2006), ¶1617a (“A ‘market development’ expenses is a cost borne by pioneers but not by later entrants. It clearly includes advertising or promotional activities that cannot be expected to have a prompt

such situations, pioneering retailers are explained to fear that later retailers that don't engage in such pioneering efforts will take advantage of their initial market development investments (i.e., free ride) and thus the pioneering retailer may decide against carrying the new product or investing in its market development. The thesis also relates to the incentive incompatibility thesis given later retailers may, by definition, be discounters that threaten incentives on the part of pioneering retailers to distribute the product.<sup>550</sup> The adverse effects of discounters are at the core of the incentive incompatibility thesis. Given these similarities, but for any temporal distinctions, the general criticisms and challenges that apply to the free rider theory<sup>551</sup> and the criticisms and challenges that apply to the incentive incompatibility theory<sup>552</sup> apply to the new product theory of RPM.

Given the inherent issues and associated limitations that apply to the new product theory of RPM, scholars including Areeda and Hovenkamp, advise caution in accepting manufacturer claims that their use of RPM is justified based upon its ability to facilitate introduction of new products.<sup>553</sup> Thus, to assess whether RPM, in fact, facilitates new entry it is advisable to look at the evidence with the aid of certain presumptions. In this regard, Areeda and Hovenkamp conclude that, "the new entry justification thus seems presumptively inapplicable to resale price maintenance."<sup>554</sup> The authors do acknowledge that actual proof that RPM aided entry might be available, but advise that satisfying the requisite proof required will often be elusive.<sup>555</sup> For example, a court might assess the applicability of the central elements of the thesis through examining the actual magnitude of the pioneering retailer's market development costs, whether retailers in fact demanded protection from intrabrand competition as a condition of undertaking the costs, and whether at the time the manufacturer reasonably believed that acceding to the retailers' demands was necessary to obtain retailer's cooperation in incurring these costs.<sup>556</sup> Depending on whether the RPM was challenged early in its life or later, one would then need to consider the ongoing applicability of the theory by estimating prospective recoupment by pioneering retailers or determine whether and to what extent actual costs market development costs have been incurred by pioneering retailers, and whether and to what extent they have been recouped through the use of RPM.<sup>557</sup>

The theoretical issues, associated limitations, and evidentiary shortcomings of the new product theory of RPM also challenge application of the thesis to the pricing practices of contact lens manufacturers. *First*, given the theory applies only to new products, it does not justify the adoption of RPM on existing products by Johnson & Johnson or other contact lens manufacturers that adopt restrictive pricing practices for their existing products. *Second*, to the extent that

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payoff. ... Because the later dealer presumably enters at a time when the product enjoys sufficient consumer appeal to support profitable distribution, that dealer avoids the losses borne by the pioneer, ...").

<sup>550</sup> Elzinga (2008), 1848 (As these authors describe "[t]o secure entry, a new entrant may seek to gain retail distribution by offering independent retailers protection against discounting, in the hope that margin protection will induce retailers to market and promote the new product.").

<sup>551</sup> See discussion supra.

<sup>552</sup> See discussion supra.

<sup>553</sup> Areeda & Hovenkamp (2006), ¶1617a3 ("Since a distribution restraint can serve so many other purposes, it's mere adoption does not mean that entry has been or will be facilitated. Because manufacturers have an incentive to claim any tenable exculpation once a particular restraint has been challenged, the manufacturer's mere claim that a restraint facilitates entry is insufficiently probative.").

<sup>554</sup> Areeda & Hovenkamp (2006), ¶1617a3.

<sup>555</sup> Areeda & Hovenkamp (2006), ¶1617a3 ("Unfortunately, satisfying proof on these points will often be elusive.").

<sup>556</sup> Areeda & Hovenkamp (2006), ¶1617a3.

<sup>557</sup> Areeda & Hovenkamp (2006), ¶1617a3.

manufacturers do attempt to justify their pricing practices based upon the new product theory, they will need to explain why based upon identified issues with the theory (e.g., the pricing, diversion, and double-cross problems)<sup>558</sup> other practices are not more suitable for encouraging new entry.<sup>559</sup> *Third*, given its association with other theories (i.e., free rider and incentive incompatibility), contact lens manufacturers will also have to explain why the general criticisms and challenges to those theories do not apply.<sup>560</sup> *Fourth*, in addition, the contact lens manufacturers will also have to explain why the more specific concerns that limit applicability of the free rider and incentive incompatibility theories do not also apply to the new product theory.<sup>561</sup> *Fifth* beyond the aforementioned issues and limitations, contact lens manufacturers will need to overcome the enumerated evidentiary shortcomings to establish proof that the theory justifies their restrictive pricing practices. *Sixth*, to the extent the new product theory is relied upon, the theory does not justify the permanent use of restrictive pricing practices on the part of any contact lens manufacturers. For these reasons and potentially others, it likely will be difficult to contend that contact lens manufacturers pricing practices are explained and therefore justified because they facilitate introduction of their new products.

*The loss leader thesis.* Statements made by Johnson & Johnson suggest that they may also attempt to justify their pricing practices based upon their ability to protect against the confusing and misleading effects of rebates. According to Laura Angelini, President of Johnson & Johnson and as stated by Eric Helms of Johnson & Johnson, respectively:

“[A]lso, by removing the complexity of rebates and building these savings into our new pricing, we believe we will be able to reach more patients with instant savings, while providing a simpler approach for everyone.”<sup>562</sup>

“... we eliminated rebates that are confusing and misleading to consumers, as well as implemented a new policy with price floors”<sup>563</sup>

Statements made by Johnson & Johnson suggest their pricing practices are also justified based upon their protection of the reputation of their products. According to Dr. Carol Alexander, a director with Johnson & Johnson,

“By reigning in such rarely-used rebates, we were able to provide lower prices, protect the reputation of our products, and focus on our highest priority, the doctors and their patients”<sup>564</sup> “By eliminating rarely-used rebates, we are better able to provide lower prices. We can protect the reputation of our products and focus on our highest priority, the doctors and patients.”

In Johnson & Johnson’s case, the manufacture’s stance against rebates relates directly to its restriction of resale prices given the manufacturer’s rebates have the effect of lowering the resale price realized by consumers. Johnson & Johnson’s stance against rebates also relates to its restriction of resale prices because rebates offered by retailers are only “permitted as long as the per unit purchase price after the rebate is applied, remains equal or above the price set by the

<sup>558</sup> Samourkachian (2015), 3-4 (Describing concerns for these effects in relation to Johnson & Johnson’s pricing practices: “And they can change at any time. They could change it tomorrow. So it’s murky because of that ...”).

<sup>559</sup> See discussion on Less Restrictive Alternatives, *infra*.

<sup>560</sup> See discussion *supra*.

<sup>561</sup> See discussion *supra*.

<sup>562</sup> Laura Angelini, Johnson & Johnson, letter addressed to ECPs, (2014).

<sup>563</sup> Helms (2015), 13.

<sup>564</sup> Dr. Carol Alexander, Johnson & Johnson, Utah Legislative Session, 9 (2015).

manufacturer.”<sup>565</sup> Johnson & Johnson’s pricing restrictions also relate to retailer rebates because the restriction “covers both the advertised price and the final sale price.”<sup>566</sup> Various other aspects of Johnson & Johnson’s pricing restrictions also relate to retailer rebates.<sup>567</sup>

Although not directly referenced, the statements by Johnson & Johnson appear to invoke past explanations for RPM that describe its use to eliminate the adverse effects theorized to result from practices (mainly loss-leader pricing) that confuse and mislead consumers<sup>568</sup> and/or denigrate a manufacturer’s brand reputation.<sup>569</sup> Loss-leader practices involve “the featuring of items priced below cost or at relatively low prices to attract customers to the seller’s place of business.”<sup>570</sup> As a practice, rebates are commonly featured and can result in relatively lower realized prices for consumers. As described by Yamey and others,<sup>571</sup> in the past these and other practices have been theorized to result in a number of adverse effects relied upon to justify RPM:

The charges laid at the door of loss-leader selling – and constituting defenses of RPM – are directed against three types of effects it is said to have. First, it is said to jeopardize the goodwill of established brands, to disturb their steady supply and thereby raise costs, affect their ready availability, or prejudice the maintenance of their quality. Second, it is said to be a device by which large-scale retail firms can drive their competitors out of business and so establish effective monopoly positions. Third, it is said that consumers, as shoppers, are confused and misled by loss-leader selling.”<sup>572</sup>

However, as found by Yamey and others there exist analytical shortcomings and a lack of available empirical evidence supporting these effects.<sup>573</sup> Thus, as concluded by Yamey “..., the tendency in public policy ... is to divorce the issue of RPM from that of loss leader selling.” According to Yamey, “This is both reasonable and sensible, because RPM is at best a crude instrument with which to attempt to curb or to control loss-leader selling.” More recently, Areeda and Hovenkamp similarly criticize the analytical basis of the loss-leader theory. These authors also conclude in relation to the empirical relevance of the loss leader theory that the “dangers”

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<sup>565</sup> See Costco Complaint and Demand for Jury Trial, (2015), Exhibit E ACUVUE Brand Contact Lenses, Unilateral Price Policy – Club Store Retailer Amendment (“Are rebates or discounts permitted under this policy? a. Yes. Rebates and discounts are permitted as long as the per unit purchase price after the rebate or discount is applied remains equal to or above the UPP price. For example, if you sell a box of 1-DAY ACUVUE® MOIST® for Astigmatism Brand with a 10% discount off of an original price of \$40.00, the final price to the customer would be \$36.00. This is above the UPP of \$34.50 and would not violate the UPP. If you offered at 15% discount off of a \$40.00 price, this would be a violation because the final price to the consumer would be \$34.00 NOTE: Professional Service Recovery Reimbursement offers issued by JJVCI to refit patients following product discontinuations are excluded when calculating final per unit purchase price.”).

<sup>566</sup> Costco Complaint and Demand for Jury Trial, (2015), Exhibit E, ACUVUE Brand Contact Lenses, Unilateral Price Policy – Club Store Retailer Amendment (“Does the UPP apply to advertised prices as well? a. Yes, the UPP covers both the advertised price and the final sale price.”).

<sup>567</sup> For example, Johnson & Johnson’s pricing restrictions relate to “combined product discount that includes in-office or in-store credit” and “combined product discount when less than an annual supply is purchased” that may include rebates and result in the price of manufacturer’s products falling below its established price. See Costco Complaint and Demand for Jury Trial, (2015), Exhibit E, ACUVUE Brand Contact Lenses, Unilateral Price Policy – Club Store Retailer Amendment.

<sup>568</sup> Yamey (1966), 17-18.

<sup>569</sup> Yamey (1966), 17-18.

<sup>570</sup> American Marketing Association, Ama.org, Dictionary (2015), <https://www.ama.org/resources/Pages/Dictionary.aspx?dLetter=L>.

<sup>571</sup> Areeda & Hovenkamp (2006), ¶1619 (“Several decades ago, it [resale price maintenance] was commonly defended as preventing ‘loss leaders.’”).

<sup>572</sup> Yamey (1966), 18.

<sup>573</sup> Yamey (1966), 18.

and “problems” of loss-leader pricing are “somewhat exaggerated” and “a problem that does not appear to be overwhelming.”<sup>574</sup> These authors further opine that, “...resale price maintenance seems a very drastic remedy for loss-leader selling.” Thus, Areeda and Hovenkamp conclude, “It seems that the potential for loss-leader selling does not offer any general justification for resale price maintenance.”<sup>575</sup> Similar sentiments are shared by other scholars of RPM.<sup>576</sup> Finally, the loss-leader theory of RPM was not included in the procompetitive theories of RPM identified by the Supreme Court in *Leegin*.<sup>577</sup>

Beyond the aforementioned analytical and empirical shortcomings, practical issues also challenge justification of contact lens manufacturers pricing practices based upon a loss-leader theory of RPM. *First*, manufacturers do not contend that consumer confusion or harm to their brand reputation has occurred. Instead, manufacturers contend that their rebates are rarely used.<sup>578</sup> Thus, it is unclear to what extent any of the contended effects (i.e., consumer confusion, consumers being misled, and the need for brand protection) actually exist. *Second*, given the manufacturer’s rebates are described to be rarely used. It is further unclear that any of the contended effects would be substantial should they be shown to exist. *Third*, even if the contended effects could be shown to exist and to be substantial, manufacturers need not restrict retail pricing to address these effects. Instead they could simply choose to no longer offer the manufacturer rebates to which they ascribe to be the source of the issues. *Fourth*, by restricting prices to address the contended effects of their rebates, manufacturers have been alleged to have created more confusion surrounding their retail prices. In this respect, Plaintiffs and others allege that manufacturers pricing restrictions related to rebates have led to less, not more, price transparency;<sup>579</sup> resulted in greater, not less, pricing complexity;<sup>580</sup> caused ECPs to focus more on contact lens prices and less on patient care;<sup>581</sup> affected the use of retailer rebates by some

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<sup>574</sup> Areeda & Hovenkamp (2006), ¶1619 (Describing the “dangers” and “problems” of loss-leader pricing as “somewhat exaggerated” and “a problem that does not appear to be overwhelming.”).

<sup>575</sup> Areeda & Hovenkamp (2006), ¶1619.

<sup>576</sup> In their paper addressing the economics of resale price maintenance for the American Bar Association, Kenneth Elzinga and David Mills (2008) do not mention the loss-leader theory of RPM or list any of the underlying concerns relied upon to justify RPM. For a discussion of elements of the theory that focus on brand reputation and its application to consumers that seek exclusivity and status through their purchases see Barak, Orbach, *The Image Theory: RPM and the Allure of High Prices*, 55 ANTITRUST BULLETIN 277 (2010). It is unclear that these attributes are sought by purchasers of contact lens.

<sup>577</sup> *Leegin* (2007) (The Court does discuss both brand image and reputation, but exclusively in the context of free riding.).

<sup>578</sup> Helms, Johnson & Johnson (2015), 34-35 (“We have to be considering that very rarely did these rebated prices ever get achieve. In fact, we estimate that about 10 percent of consumers ever really achieve the rebate price.”).

<sup>579</sup> Costco Complaint and Demand for Jury Trial 13 (2015) (According to Plaintiffs, “On August 7, J&J sent Costco a further revised RPM Policy (“Fourth RPM Policy”) making clear that any in-store credit as part of a now permitted combined product discount cannot be advertised externally. Exhibit D at 3. This restraint was the result of further negotiation between J&J and other retailers that were alarmed that in-store credits through gift cards would be permitted under the Third RPM Policy. To assuage this concern, J&J agreed with them in its Fourth RPM Policy to prohibit the external advertisement of such credits and thus limit their effectiveness as a method of competition. This prohibition came in spite of J&J otherwise claiming to promote “transparency” in the Contact Lens Markets.”)

<sup>580</sup> Costco Complaint and Demand for Jury Trial (2015) (Describing the complex interplay of manufactures pricing restrictions and their rebate policies).

<sup>581</sup> Marn Larsen-Ball Complaint (2015), 41 (“Furthermore, the Manufacturer Defendants’ RPM Policies do not encourage ECPs to focus more on patient needs instead of contact lens costs. Instead, they do just the opposite; as several ECPs have said, a “savvy” ECP will always prescribe a contact lens subject to a MRPM agreement over another one, because the ECP will earn a greater profit.”).



retailers and their consumers;<sup>582</sup> driven cost conscious consumers to adopt less simple savings tactics;<sup>583</sup> and reduced healthy purchase practices on the part of affected consumers.<sup>584</sup> For these reasons and potentially others, it likely will be difficult to contend that contact lens manufacturers pricing practices are explained and therefore justified because they eliminate the adverse effects theorized to result from practices (i.e., rebates) that confuse and mislead consumers and/or denigrate a manufacturer's brand reputation.

### Directions for Analysis

Analyses that bear in mind the aforementioned insights should be helpful to ongoing assessments of the competitive implications of contact lens manufacturers' pricing practices. Given its historical relevance, these analyses should investigate the applicability of the free rider thesis. Emphasis should be given to investigating the factors that support or challenge the plausibility of the thesis as a justification for manufacturers pricing practices. Because of its contemporary popularity, these analyses should also investigate the applicability of the incentive incompatibility thesis including factors that support or challenge its plausibility as a justification for manufacturers' pricing practices. Other theories thought to potentially apply and explain manufacturers' pricing practices should be examined in the same way. Criticisms and challenges to each thesis have been identified over time. In addition, more specific criticisms and challenges to each thesis were identified relative to their ability to explain and justify the pricing practices of contact lens manufacturers. Each of these criticisms and challenges should be thoroughly investigated.

In respect to the free rider thesis, particular emphasis should be given to assessing the credibility of claims that free riding is a concern, understanding the factors that point to the continuing viability of ECPs as a distribution system for contact lens, the ability of ECPs to recoup the cost of desired promotional services through patient payments, the complexity of applying the free rider thesis to the different purchase occasions that accompany the purchase of contact lenses, and whether given their professional role and identified goals ECPs need to be induced to offer the promotional services contemplated by the free rider thesis.

In regard to the incentive incompatibility thesis, particular emphasis should be given to understanding the extent to which any promotional efforts induced by manufacturers pricing practices are not brand specific and therefore lessen incentives on the part of ECPs to offer the promotion (i.e., the nonbrand-specific promotion effect); the extent to which a patient's reliance on their ECP to select a contact lens for them impacts the efficacy of the ECP's promotional efforts to increase incremental demand for the manufacturer's contact lens (i.e., the buying participant phenomenon), the extent inter-retailer demand effects result from an ECP's

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<sup>582</sup> Costco Complaint and Demand for Jury Trial (2015) (Manufacturers pricing practices require that the use of retailer rebates not amount to retail prices that fall below the retail price. Some retailers report these rebates are widely used by their customers. Costco reports that nearly 70% of their customers use Costco rebates.) See *Illinois House bill 2450 Hearing*, 3 (2015).

<sup>583</sup> Stopupp.org, *Money Saving Tips to Beat UPP* (2015), <http://www.stopupp.org/#save>. (reporting "Money Savings Tips to Beat UPP" including case back sites, taking advantage of retailer loyalty programs, and asking your doctor to try a different brand.).

<sup>584</sup> Garth Vincent, Attorney Munger, Tolles & Olsen, Utah Legislative Hearing, *Consumer Protection Act*, 20 (2015) ("So eliminating price fixing and allowing consumers to obtain discount prices will not negatively impact consumer health. To the contrary, it's been well-established by the Federal Trade Commission, state attorneys general, including the state of Utah, that the ability of consumers to obtain their replacement lenses more cheaply encourages them to replace them more frequently and actually promotes consumer health.").

promotion of a manufacturer's contact lens (i.e., service characteristic effect), and the extent to which differences in contact lens patients' desire for retail promotion occur and consequently impact the net welfare benefits predicted for RPM (i.e., effects of consumer differences).

Finally, some emphasis should be given to analyses that support or challenge the plausibility of other explanations of RPM's beneficial effects as a justification for the pricing practices of contact lens manufacturers. This includes explanations that the use of RPM facilitates the introduction of new products. Although this explanation has theoretical issues, associated limitations, and evidentiary shortcomings, the statements and actions of some manufacturers appear to invoke this explanation. This also includes past explanations that focus on the use of RPM to eliminate the adverse effects theorized to result from practices that confuse and mislead consumers. Despite that analytical, empirical and practical issues attend this explanation, at least one manufacturer has intimated the explanation explains and justifies their pricing practices.

## LESS RESTRICTIVE ALTERNATIVES

Even where RPM is shown to serve a legitimate business function, antitrust law requires that the use of RPM be reasonably necessary.<sup>585</sup> Thus, a manufacturer's justification for RPM based on its ability to resolve externalities associated with free riding, aid in the address of incentive incompatibilities, or eliminate the adverse effects of practices that confuse or mislead consumers and/or denigrate a manufacturer's brand; may be rebutted where competitively less restrictive alternatives are found to be reasonably available.

### Role of Less Restrictive Alternatives

The availability of less restrictive alternatives impacts assessment of the benefits of RPM, the harms that can result, and the degrees of proof necessary to show that RPM either endangers competition or promotes it.<sup>586</sup> A showing of a legitimate business function served by RPM may, or may not, be sufficient to negate<sup>587</sup> or outweigh<sup>588</sup> the harmful effects of RPM. Moreover, the possibility cannot be excluded that even where RPM serves a legitimate function that the function cannot be achieved as well by less restrictive means.<sup>589</sup> Thus, assessment of reasonably available and competitively less restrictive alternatives is important to assessments of practices that restrain trade including RPM.

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<sup>585</sup> Areeda & Hovenkamp (2006).

<sup>586</sup> Areeda & Hovenkamp (2006), ¶1602.

<sup>587</sup> Areeda & Hovenkamp (2006), ¶1633d (Describing the negating effect of legitimate objectives for RPM: "First, it usually negates anticompetitive effects in one important situation: anticompetitive dealer interests cannot be served by a restraint that is no more restrictive than necessary to serve a legitimate manufacturer interest. However, other potential evils are not negated by a legitimate function. Vertical restraints adopted for entirely proper reasons may nevertheless help manufactures coordinate their prices horizontally. Similarly, widespread restraints among multi-brand dealers will tend to encourage "deceptive" recommendations to consumers even though legitimate functions are also served: they may also prove resistant to abandonment by each manufacturer individually.").

<sup>588</sup> Areeda & Hovenkamp (2006), ¶1633d (Describing the outweighing effects of legitimate objective for analysis of RPM: "Second, even where a procompetitive benefits does not negate the existence of some detriments to competition, it might outweigh them – especially where the detriments are not actually proved by merely inferred as significant dangers...").

<sup>589</sup> Areeda & Hovenkamp (2006), ¶1633d (Describing the role of less restrictive means for achieving a legitimate function in the analysis of RPM: "Nor can we be confident that a particular restraint serves legitimate and substantial functions that cannot be achieved as well by less restrictive means.").

### Alternatives to RPM for Inducing Retail Promotion

As a strategy for obtaining retail promotion, RPM is explained to compensate retailers for their promotional effort through limiting the resale price below which a manufacturer's products can be sold. Limiting the resale price of the manufacturer's product grants retailers a higher margin on the product and compensates them for their promotional efforts. Alternatives to RPM for obtaining retail promotion of a manufacturer's product have long been recognized in antitrust.<sup>590</sup> For example, Sullivan and Grimes describe that a producer wishing to promote its product – and build and maintain a reliable dealer network – can choose among the following options:

“Beat the competition on price (a low price strategy could allow dealers to carry the product and still sell it at an attractive margin); institute producer-sponsored advertising that will build consumer brand loyalty; send producer representatives to retail outlets to perform promotional services; provide for a producer buyback of a retailer's unsold inventory, lessening the retailer's risk in carrying the brand; use promotional allowances to reward retailers for any of a variety of dealer-performed promotional services including local advertising, on-site demonstrations, or prominent displays; institute a distribution restraint that ensures the dealer a high margin for selling the product; establish a franchise network of retail outlets; and purchase retail outlets (vertical integration).”<sup>591</sup>

Similarly, Areeda and Hovenkamp identify various options for manufacturers who want to assure relevant promotional services for their products. As described by the authors:

“...we can see many obvious ways to assure the relevant services. (1) The dealer might charge separately for services it furnishes to consumers. (2) The manufacturer might advertise the product or provide the necessary services itself. (3) The manufacturer might raise its wholesale price generally but then reimburse dealers for qualifying expenditures on advertising and services. (4) The manufacturer might require all dealers to maintain specified facilities and to provide specified services and then refuse to continue supplying those whose facilities or services fall short. (5) The manufacturer might restrain distribution in a different way – for example, through territorial restriction rather than resale price maintenance or through a location restriction or profit pass-over rather than ‘air-tight’ territorial confinement. (6) The manufacturers might distribute its product itself without using independent dealers at all. Alternatively, the manufacturer might think it too costly to intervene and leave dealers free to do as they please.”<sup>592</sup>

Additional strategies, including those applicable to circumstances where retail promotion may be discouraged due to conflicts between traditional brick-and-mortar and Internet retailers, are described by Kalyanam and Tsay.<sup>593</sup> These include “lowering prices” and “price matching” policies aimed at encouraging promotion by discouraging customers from shopping in one store for a manufacturer's product and then purchasing it from another. It also includes “product exclusivity” approaches such as authorizing particular retailers to carry the manufacturer's products (i.e., “SKU authorization”), developing product variations that are unique to a particular retailer (i.e., “branded variants”), and producing products that bear a retailer's brand (i.e., “private label brands”). Also included are shopper-centric strategies including “hybrid marketing” arrangements that integrate different retail channels to match the shopping

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<sup>590</sup> Grimes & Sullivan (2006), 336-7. Areeda & Hovenkamp (2006), ¶1602.

<sup>591</sup> Grimes (2006), 336-7.

<sup>592</sup> Areeda & Hovenkamp (2006), ¶1602.

<sup>593</sup> Kalyanam & Tsay (2013), 19.

preferences of customers (i.e., retail showrooms/online purchase; buy online/pickup in store; etc.).

*Comparative efficiency of alternatives and RPM.* The aforementioned alternatives for obtaining retail promotion of a manufacturer's products are not equal and depending on the circumstances some alternatives may work better than others.<sup>594</sup> However, a primary contention of procompetitive theories employed to justify RPM is that when compared to alternatives, RPM is a more efficient solution for obtaining retail promotion of the manufacturer's products. As explained for the incentive incompatibility thesis, despite alternatives like direct payments by manufacturers for promotion (i.e., promotional allowances) and limited distribution (i.e., exclusive and selective distribution) may be chosen to obtain retail promotion,<sup>595</sup> it is believed to be more common for manufacturers to enter into general understandings that leave it to retailers to determine what promotional efforts to engage in.<sup>596</sup> This view of promotional arrangements extends from theories of organization in economics applied to RPM that contend "because of the difficulties of specifying detailed retailer performance, it is more common for manufacturers to enter more general understandings with their retailers regarding the promotional efforts they expect retailers to devote to the sale of their products and to leave it up to the retailer to determine the details of how this should be accomplished."<sup>597</sup> Consequently, it is assumed that "... resale price maintenance often will be an efficient way for manufacturers to compensate retailers for supplying dedicated promotion efforts in such contractual arrangements."<sup>598</sup> In theory, given the view that "incomplete information and monitoring costs make writing and enforcing such contracts problematic," RPM "spares the manufacturer the task of specifying and monitoring the retailer's performance."<sup>599</sup>

Although not elaborating on the underlying rationale, the view that RPM may be the most efficient way to obtain retailer promotion is also described by the Supreme Court in *Leegin*, where the majority observed that:

"It may be difficult and inefficient for a manufacturer to make and enforce a contract with a retailer specifying the different services the retailer must perform. Offering the retailer a guaranteed margin and threatening termination if it does not live up to expectations may be the most efficient way to expand the manufacturer's market share by inducing the retailer's performance and allowing it to use its own initiative and experience in providing valuable services."<sup>600</sup>

Despite economic logic and judicial description that reasons RPM and related strategies (UPP) are a more efficient solution for obtaining retail promotion of a manufacturer's product, as previously described, RPM has been argued to be an inefficient strategy: (1) when considering the necessary monitoring and enforcement resources necessary to insure retailers adhere to RPM

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<sup>594</sup> Grimes (2006), 336-7 ("The listed alternatives are not equal. Depending on the circumstances, some will work better than others"). Areeda & Hovenkamp (2006), ¶1602.

<sup>595</sup> Klein (2009), 464 ("In some cases, the market equilibrium may involve preferential or de facto exclusive retailer promotion devoted to a single manufacturer's products; in other cases, multiple manufacturers will compensate and received dedicated retailer promotion of their products.").

<sup>596</sup> Klein (2009), 449.

<sup>597</sup> Klein (2009), 449.

<sup>598</sup> Klein (2009), 464.

<sup>599</sup> Elzinga & Mills (2008), 1844.

<sup>600</sup> *Leegin* (2007), 892.

and that the desired promotional services are actually provided,<sup>601</sup> (2) where its use results in misleading and deceptive forms of presale promotion that steers consumers to purchase products that they may not otherwise,<sup>602</sup> (3) to the extent that its use encourages promotional services unneeded or undesired by comparatively larger groups of consumers than those that need or desire it,<sup>603</sup> (4) to the degree that its use leads to RPM by other manufacturers that cancels out its demand increasing effects,<sup>604</sup> (5) where its use adversely impacts retail innovation and growth (i.e., dynamic efficiencies),<sup>605</sup> and (6) when compared to alternative methods for accomplishing the same outcome that do not restrict retail price competition.<sup>606</sup> Consequently, debate exists as to the comparative efficiency of RPM and alternatives as a strategy for inducing retail promotion of a manufacturer's products.

### Implications for the Current Debate

To the extent that contact lens manufacturers are found to have limited retail price competition through RPM, an important area of inquiry in the current debate will involve the reasonable necessity of their pricing practices. Thus, an important question is what role these less restrictive alternatives will take. Justifications offered by manufacturers based upon the efficiency of their pricing practices in inducing retail promotion of their products may be rebutted where competitively less restrictive alternatives are reasonably available. Consequently, an important area of inquiry regards the efficiency of contact lens manufacturers' pricing practices and the reasonable availability of less restrictive alternatives to these practices.

**Trends in trade promotion management.** While theoretical debate exists concerning the comparative efficiency of RPM and alternatives that are less restrictive of competition, trends in the trade promotion activities of consumer goods companies indicate that manufacturers are spending increasing amounts of their promotional budgets on alternative strategies. One such strategy involves promotional allowances designed to compensate retailers for their promotional efforts in ways that are directly linked to the retail sales performance of a manufacturer's product.<sup>607</sup>

**Promotional allowances.** According to surveys of trade promotion activities by consumer goods companies, over the last several decades spending on promotional allowances and other forms of trade promotion (e.g., temporary price reductions, display allowances, etc.) has increased over time and now represents more than one-half of manufacturer's overall budget for promotion.<sup>608</sup> More importantly, these surveys reveal that manufacturers are increasingly allocating their trade promotion expenditures to approaches that yield greater accountability of

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<sup>601</sup> Hollander, 82 (1966). Grimes (2010).

<sup>602</sup> Grimes (2010).

<sup>603</sup> Comanor (1984).

<sup>604</sup> Yamey (1954). Brief of William S. Comanor and Frederic M. Scherer as Amicus Curiae Supporting Neither Party 9, *Leegin Creative Leather Products v. PSKS, Inc.*, 551 U.S. 877 (2007).

<sup>605</sup> Grimes (2010).

<sup>606</sup> Grimes (2010).

<sup>607</sup> Ramarao Desiraju & Sridhar Moorthy, *Managing a Distribution Channel under Asymmetric Information with Performance Requirement*, 43 *MANAGEMENT SCIENCE* 1628 (1997) ("Performance requirements – with direct monitoring to ensure retailer compliance – seem to have the potential to control the retailer's behavior directly...").

<sup>608</sup> Miguel I. Gomez, Vithala R. Rao & Edward W. McLaughlin, *Empirical Analysis of Budget and Allocation of Trade Promotions in the U.S. Supermarket Industry*, 44 *JOURNAL OF MARKETING RESEARCH* 410 (2007).



the promotional activities engaged in by retailers.<sup>609</sup> This includes so-called “pay-for-performance” arrangements that are more specific in their requirements and that produce increased accountability on the part of retailers for the compensation they receive from manufacturers (e.g., bill-backs, scan-backs, third-party auditors, etc.).<sup>610</sup> It also includes the growing use of data and methods (e.g., scanner data, merchandise response analysis, promotion analytics, etc.) that aid manufacturers’ understanding of a retailer’s promotional activities and resulting sales performance.<sup>611</sup>

The identified trends in trade promotion are noteworthy given they indicate that alternatives to RPM such as promotional allowances have become an increasingly common approach by manufacturers for gaining retail promotion of their products. Like RPM, these arrangements compensate retailers for their promotional efforts. However, unlike RPM, they do not restrict competition involving retail prices for the manufacturer’s product. The trends for trade promotion are also noteworthy given they reflect movement toward requiring greater accountability on the part of retailers in their promotional efforts. This trend contradicts the foundational logic relied upon to explain the comparative efficiency of RPM over less restrictive alternatives. As the surveys indicate, rather than approaches that involve a general understanding of the promotional efforts expected of retailers and that leave it up to retailers to determine the details, manufacturers are increasingly utilizing approaches that are more specific in their requirements and that produce more accountability of on the part of retailers for the compensation they receive from manufacturers.

**Trends in multi-channel management.** In addition to the aforementioned trends, manufacturers are also adopting entirely new approaches for obtaining promotion of their products at retail. One approach is especially noteworthy given it involves a paradigm shift in the way customer behavior that is at the core of the free riding thesis is viewed.<sup>612</sup> Rather than

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<sup>609</sup> John P. Murry, Jr. & Jan B. Heide, *Managing Promotion Program Participation within Manufacturer-Retailer Relationships*, 62 JOURNAL OF MARKETING 58 (1998) (“Approximately 37% of all consumer product manufacturers systematically monitor retailers for compliance with their display programs...”). Kenneth Anselmi, *A Brand’s Advertising and Promotion Allocation Strategy: The Role of the Manufacturer’s Relationship with Distributors as Moderated by Relative Market Share*, 48 JOURNAL OF BUSINESS RESEARCH 113 (2000) (“In 1970, trade promotions represented only 7% of the total advertising and promotion expenditures... by 1995, packaged goods trade promotions had increased to 51%... This reallocation of funds in the advertising and promotion budget reflects a shift in power to distributors...”).

<sup>610</sup> Desiraju (1997), 1641 (“This change has eliminated in one stroke a major source of conflict between manufacturers and retailers. In the old system, manufacturers complained about forward buying by the retailer, diversion, and pocketing of trade incentives without complying with performance requirements. With scan-back promotions, the retailer does not gain from these practices.”).

<sup>611</sup> Desiraju (1997), 1641 (“The advent of electronic scanners at check-out counters and advances in information technology, e.g., electronic data interchange (EDI), have reduced the costs of monitoring pricing performance. As a result, several consumer goods companies have changed their trade promotion format from simply giving retailers an off-invoice discount and hoping for “pass through” to “scan-back promotions” where the discount is given only on the basis of scanner data showing that the retailer passed on the discount...”).

<sup>612</sup> Discouraging intrabrand cross-channel shopping behavior on the part of consumers is central to existing explanations that describe RPM’s procompetitive effects. Cross-channel shopping behavior of consumers that involves learning about a manufacturer’s product at one retailer and then purchasing the product at another retailer (i.e., a discount retailer) is at the core of the free rider thesis. The phenomenon of consumers being drawn to discount retailers is also at the heart of the incentive incompatibility thesis. In each case, the uniform price floor created by RPM is explained to deter consumers from shopping across retailers in search of a better price. In the free rider thesis, RPM leaves consumers with little incentives to engage in cross-channel shopping, thereby eliminating the threat that intrabrand free riding will keep retailers from offering desired promotional services. In the incentive



strategies like RPM (and UPP) that try to discourage customers from shopping across channels when purchasing a manufacturer's product, a growing literature describes how manufacturers are encouraging this behavior on the part of customers and profiting from it.<sup>613</sup> Known as hybrid marketing, and involving multi-channel management and shopper-centric strategies, this trend reflects an increasingly important alternative to RPM.<sup>614</sup>

**Shopper-centric strategies.** As an approach to retail promotion, shopper-centric strategies encourage, rather than discourage, customer behavior that is at the core of the free riding thesis (i.e., cross-channel shopping).<sup>615</sup> Customers are encouraged to shop in channels that they prefer including across multiple channels should they choose to do so. In response, manufacturers integrate and harmonize the promotional offerings of their different retail channels<sup>616</sup> to the shopping patterns that their customers prefer.<sup>617</sup> For example, where customers prefer to obtain information about a manufacturer's product from one channel (e.g., Internet channel), but then make their purchase through another channel (e.g., a brick-and-mortar channel), manufacturers coordinate the channels to meet the customer's shopping preferences (e.g., buy online/store pickup). Employing advances in information technology, manufacturers develop methods for monitoring and compensating each channel member for their contribution to a purchase.<sup>618</sup> These include double-pay pricing arrangements that monitor and compensate brick and mortar retailers closest to a customer's address for sales made online.<sup>619</sup> They also include compensation models that monitor and reward each channel based on their different promotional activities, prior investment in value added activities, or customer satisfaction

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incompatibility thesis, RPM keeps consumers from being drawn to discount retailers that would otherwise offer lower prices, thereby eliminating the threat that these retailers will compete away the compensation provided to retailers that offer desired promotional services.

<sup>613</sup> Gregory T. Gundlach, Kenneth C. Manning & Joseph P. Cannon, *Resale Price Maintenance and Free Riding: Insights from Multi-Channel Research*, 1 ACADEMY OF MARKETING SCIENCE REVIEW 18 (2011). Scott A. Neslin, Dhruv Grewal, Robert Leghorn, Venkatesh Shankar, Marije L. Teerling, Jacquelyn S. Thomas & Peter C. Verhoef, *Challenges and Opportunities in Multichannel Customer Management*, 9 JOURNAL OF SERVICE RESEARCH 95 (2006) ("customers who shop through any two of three channels (direct mail, store, and Internet) spend more than twice as much as customers who shop at any one channel alone and that customers who shop through all the three channels spend more than three times as much as customers who shop at any one channel.").

<sup>614</sup> Adrian Payne & Pennie Frow, *A Strategic Framework for Customer Relationship Management*, 69 JOURNAL OF MARKETING 167 (2005) ("Today, many companies enter the market through a hybrid channel... that involves multiple channels, such as field sales forces, Internet, direct mail, business partners, and telephony.").

<sup>615</sup> Lanlan Cao & Li Li, *The Impact of Cross-Channel Integration on Retailers' Sales Growth*, 91 JOURNAL OF RETAILING 198 (2015) ("Cross-channel integration helps retailers introduce consumers who visit one channel to other channels, which builds loyalty and cross-buying... For example, by encouraging consumers to browse product availability in their local stores, retailers direct them from the website to store. Once in the store, consumers have lower service demands and can be exposed to cross-selling...").

<sup>616</sup> Lih-Bin Oh & Hock-Hai Teo, *Consumer Value Co-Creation in a Hybrid Commerce Service-Delivery System*, 14 INTERNATIONAL JOURNAL OF ELECTRONIC COMMERCE 35 (2010) ("The retailer can analyze the information gathered across channels (e.g., customer purchase patterns, customer preferences) to make relevant purchase recommendations to its consumers. Furthermore, Web sites can be customized based on the information gathered, so that customers will be presented only with relevant information.").

<sup>617</sup> Paul F. Nunes & Frank V. Cespedes, *The Customer Has Escaped*, 81 HARVARD BUSINESS REVIEW 106 (2011).

<sup>618</sup> Erin Anderson, George S. Day, Kasturi V. Rangan, *Strategic Channel Design*, 38 SLOAN MANAGEMENT REVIEW 59 (1997) ("Because the channel member dealing with the customer no longer performs all channel functions, it cannot expect to receive a traditional margin or commission. Ideally, channel members under the new system are compensated only for the functions they perform.").

<sup>619</sup> Kalyanam & Tsay (2013).

scores.<sup>620</sup> They further include dedicating one retail channel as a “showroom” for the manufacturer’s products and another channel for completing purchases.<sup>621</sup> The overall goal is to make it easier for customers to follow their preferred shopping path. Where successful, the end result is a multichannel system that better “fits” with customers’ shopping patterns and preferences for promotional services along their chosen “path to purchase.”<sup>622</sup>

Prompted by the proliferation of retail channels, advances in information technology, and the increasingly diverse needs of customers; shopper-centric strategies of multichannel management reflect application of the well-known *marketing concept* to contemporary channel management. Adopted and practiced for decades by many firms, the marketing concept states that “firms should analyze the needs of their customers and then make decisions to satisfy those needs, better than competition.”<sup>623</sup> Shopper-centric strategies of multichannel management involve application of the marketing concept through acknowledgement of the preference of many consumers to use multiple retail channels of distribution to complete a purchase.<sup>624</sup> Manufacturers and retailers are increasingly adopting shopper centric strategies. One 2012 shopper survey found, for example, that 60% of respondents expect a seamless integrated experience across channels when shopping for a product by 2014.<sup>625</sup> Related research reports that 51% of respondents expect that by 2020 more physical stores will become showrooms for selecting and ordering products.<sup>626</sup>

**Efficiency of contact lens manufacturers pricing arrangements.** The superior efficiency claimed for RPM rests on economic reasoning that describes how manufacturers enter into more general understandings with their retailers regarding the promotional efforts they expect because of the difficulties of specifying, monitoring and enforcing retailer performance and then they leave it up to their retailers to determine the details of how this should be accomplished. However the pricing arrangements of contact lens manufacturers appear to contradict this logic.

**Detailed specifications and extensive monitoring.** The pricing practices of contact lens manufacturers are reportedly quite specific in their promotional requirements and rely upon extensive monitoring and enforcement resources to insure these required details are followed. Johnson & Johnson’s pricing policies, for example, include extensive requirements that specify the applicable channels, included brands, types of advertising and advertising claims, specifications concerning rebates, particulars regarding combined product discounts,

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<sup>620</sup> Kalyanam & Tsay (2013).

<sup>621</sup> Kalyanam & Tsay (2013).

<sup>622</sup> Kantar Retail (2010). *Transforming Trade Promotion: Shopper-Centric Approach*. Wilton, CT: Kantar Retail.

<sup>623</sup> NetMBA.com, *The Marketing Concept* (2002-2010), <http://www.netmba.com/marketing/concept/>.

<sup>624</sup> K. K. Johnson, J.-J. Yoo, J. Rhee, S. Lennon, C. Jasper & M. L. Damhorst, *Multi-Channel Shopping: Channel Use Among Rural Consumers*, 34 JOURNAL OF RETAIL AND DISTRIBUTION MANAGEMENT 453 (2006). V. Kumar & R. Venkatesan, *Who are the Multichannel Shoppers and How do they Perform?: Correlates of Multichannel Shopping Behavior*, 19 JOURNAL OF INTERACTIVE MARKETING 44 (2005).

<sup>625</sup> Capgemini Worldwide, *Digital Shopper Relevancy*, 39 (2012) (“Most importantly, shoppers made it clear that they expect a seamless integrated experience across all exchanges. Nearly 60% of all respondents said they expect this to be the norm by 2014.”), [http://www.capgemini.com/services-and-solutions/by-industry/consumer-products/digital\\_shopper\\_relevancy](http://www.capgemini.com/services-and-solutions/by-industry/consumer-products/digital_shopper_relevancy).

<sup>626</sup> Capgemini Worldwide (2012), 40 (“Most importantly, shoppers made it clear that they expect a seamless integrated experience across all exchanges. Nearly 60% of all respondents said they expect this to be the norm by 2014.”).

requirements for insurance claims, exemptions for employee and military discounts, and penalties and exclusions for violations, among other details.<sup>627</sup> In addition, to support its pricing arrangements the company employs “three separate processes for proactive Market Price monitoring.”<sup>628</sup> This includes both “internal resources (J&J employees) dedicated to researching, confirming and notifying sellers of UPP violations.”<sup>629</sup> It also includes “two (2) independent firms;” the first of these firms “monitors all online pricing and advertising, the second conducts in-store price validations nationwide.”<sup>630</sup> Further “all customer types, regardless of size, geography, distribution method, etc. are included in one or more of these monitoring efforts.”<sup>631</sup> Finally, where violations are found, according to Johnson & Johnson, it “will exercise its right to repurchase your current inventory of products subject to UPP price.”

The detailed nature of Johnson & Johnson’s pricing arrangements and the extensive monitoring efforts described fail to evidence the economic logic required to support a claim that the arrangement is an efficient mechanism for gaining retail promotion of their products. Consequently and to the extent widespread, it may be difficult for contact lens manufacturers to argue that their pricing arrangements are as efficient as reasoned by the procompetitive theories of RPM and therefore more efficient than alternatives for obtaining retail promotion, especially those that are less restrictive of competition.

**Less restrictive alternatives to contact lens pricing practices.** For obtaining retail promotion of contact lenses, the reasonableness of less restrictive alternatives to RPM in the form of fees paid by consumers, payments paid by manufacturers, and limited forms of distribution, have previously been identified and examined by the FTC and others. In addition, recent trends in multi-channel management suggest that shopper-centric strategies may also be an option.

**Fees paid by consumers.** The reasonability of compensating ECPs for their promotional services through fees paid by consumers was examined by the FTC in 2005. According to the FTC: “... ECPs are likely able to recoup at least part of the cost of promotional services as part of the contact lens fitting fees.”<sup>632</sup> Moreover, relative to any incompatibilities in the incentives of manufacturers and retailers to offer retail promotion (i.e., the incentive incompatibility thesis) according to the FTC, “If the examination fee provides ECPs with adequate compensation for providing promotional services, this payment may ameliorate any divergence between manufacturers’ and retailers’ incentives to provide these services.”<sup>633</sup> According to the FTC, empirical evidence on the extent to which ECPs are compensated through patient fees paid is needed.<sup>634</sup> Consequently it is difficult to determine the role of these fees play in determining an ECP’s promotional effort. However, the recent testimony of Dr. David Cockrell, President of the

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<sup>627</sup> Costco Wholesale Corp. v. Johnson & Johnson Vision Care, Inc., Complaint and Demand for Jury Trial, US District Court for the Northern District of California, San Francisco Division, Exhibits A-E (March 2, 2015).

<sup>628</sup> Knight (2014).

<sup>629</sup> Knight (2014).

<sup>630</sup> Knight (2014).

<sup>631</sup> Johnson & Johnson, Circular (November 5, 2015) cited in Marn Larsen-Ball Complaint (2015).

<sup>632</sup> FTC (2005), 33.

<sup>633</sup> FTC (2005), 33.

<sup>634</sup> FTC (2005), 33 (“Without empirical evidence on the extent to which ECPs are compensated for promotional services through exam fees or directly from the manufacturer, however, it is impossible to determine the role limited distribution or private label strategies play in determining an ECP’s promotional effort.”).

American Optometric Association, a leading professional organization representing ECPs, implies that patient fees do play a role in ECPs' promotional efforts. In 2014, in addition to testifying before the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights of the Committee on the Judiciary that free riding was not a problem in the contact lens industry, when asked if the reason for this was "because you're [the ECP] being paid a fee for a service that's a separate service," Dr. Cockrell testified, "By the patient, you mean? Correct."<sup>635</sup> Moreover, as determined by the nonprofit AAI and communicated in their letter to FTC and DOJ concerning allegations of RPM in the contact lens market, describe: "Contact lens wearers pay providers a separate fee for the contact lens fitting where presale promotion occurs, on top of the fee for the eye exam. In other words, eye care providers are compensated for their services and cannot suffer from free riding."<sup>636</sup>

*Payments by manufacturers.* The reasonability of compensating ECPs for their promotional services through payments by manufacturers was also examined by the FTC in 2005. According to the FTC, "... even if ECPs cannot recoup the cost of providing promotion services from consumers contact lens manufacturers may be able to compensate ECPs directly."<sup>637</sup> As explained by the FTC "For example a manufacturer could supply ECPs with education on the attributes and proper fitting techniques related to a lens."<sup>638</sup> According to the FTC, empirical evidence on the extent to which ECPs are compensated through direct payments by manufacturers is needed.<sup>639</sup> Consequently, it is difficult to determine the role payments by manufacturers for promotion play in determining an ECP's promotional effort. However, surveys that describe trends associated with strategies of trade promotion by consumer product companies' bolsters evidence of the reasonability of compensation arrangements that involve payments for retail promotion. These surveys indicate that payments in the form of promotional allowances have become more widely used by manufacturers over time. These surveys also contradict economic logic relied upon to claim the superior efficiency of RPM. The surveys find that rather than approaches like RPM that involve a general understanding of the promotional efforts expected of retailers and leave it up to retailers to determine the details, manufacturers are increasingly utilizing approaches that enable their specific understanding and involve detailed accountability of retailers' promotional efforts involving their products.

*Limited distribution arrangements.* The reasonability of employing limited forms of distribution (i.e., private label brands)<sup>640</sup> in order to encourage retail promotion was also previously examined by the FTC in 2005. According to the FTC, "[s]ome contact lens manufacturers limit the retail distribution of their lenses to outlets that have some form of eye

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<sup>635</sup> Cockrell (2014), videotape at 56.56.

<sup>636</sup> Foer (2014), 5.

<sup>637</sup> FTC (2005), 33.

<sup>638</sup> FTC (2005), 33.

<sup>639</sup> FTC (2005), 33 ("Without empirical evidence on the extent to which ECPs are compensated for promotional services through exam fees or directly from the manufacturer, however, it is impossible to determine the role limited distribution or private label strategies play in determining an ECP's promotional effort.").

<sup>640</sup> The FTC did not investigate "private brand" lenses. Given they involve a brand developed exclusively for the seller, private brand lenses involve more restrictive distribution than private label brands which involve arrangements where a retail seller sells a national name brand under a different name including a name unique to that seller (e.g., Wal-Mart, Pearle Vision, Target, Lens Crafters).

care service.”<sup>641</sup> As determined by the FTC, with respect to this limited distribution, “... the available empirical evidence ... reveals that ... limited distribution lenses are widely available from various retail channels.”<sup>642</sup> Finally, according to the FTC, “The data, moreover, do not suggest that limited distribution lenses are sold for higher prices than similar lenses that are widely available.”<sup>643</sup> As further concluded by the FTC, “[f]inally, there may be efficiencies from limited distribution ... lenses that could lead to increase competition among sellers.”<sup>644</sup> According to the FTC, empirical evidence on the extent to which ECPs are compensated through direct payments by manufacturers or patients is needed to determine the role limited distribution by manufacturers play in determining an ECP’s promotional effort.<sup>645</sup> Moreover, it is unclear to what extent the FTC’s prior analyses applies to the widespread use of limited distribution in the sale of contact lenses and the current use of private brand (as opposed to private label) contact lenses.

**Shopper-centric strategies.** Trends associated with shopper-centric strategies of multi-channel management add an important option to the list of alternatives that have been identified in antitrust as less restrictive of competition than RPM. Contrary to discouraging customers from shopping across channels when purchasing a manufacturer’s product, shopper centric strategies encourage such behavior and are therefore less restrictive of competition. Although it is not known at this time whether shopper-centric strategies are employed in contact lenses industry, the growing use of this approach in other industries<sup>646</sup> indicates its reasonableness as an alternative to RPM. In addition, the multichannel nature,<sup>647</sup> presence of lower price channels of distribution,<sup>648</sup> use of examination and fitting fees, and different purchase occasions for contact lenses also suggests its reasonableness in the contact lens industry. To the extent the shopper-centric strategies are found to apply to the distribution of contact lenses, (or could reasonably apply) as with other alternatives to RPM that are less restrictive of competition, manufacturers will find their pricing practices difficult to justify.

## Directions for Analysis

Analyses that bear in mind the aforementioned insights should be helpful to ongoing assessments of the competitive implications of contact lens manufacturers’ pricing practices. These analyses should include assessment of alternatives that are less restrictive than RPM for

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<sup>641</sup> FTC (2005), 15.

<sup>642</sup> FTC (2005), 15.

<sup>643</sup> FTC (2005), 18-19.

<sup>644</sup> FTC (2005), 19.

<sup>645</sup> FTC (2005), 33.

<sup>646</sup> Joan L. Anderson, Laura D. Jolly & Ann E. Fairhurst, *Customer Relationship Management in Retailing: A Content Analysis of Retail Trade Journals*, 14 DATA MINING APPLICATIONS IN RETAILING AND CONSUMER SERVICES 394 (2007) (“...retailers embrace a “customer-centric” focus and implement strategies to support this focus”).

<sup>647</sup> FTC (2005), 8-9 (“Manufacturers distribute their contact lenses through a variety of channels. Sellers can be grouped into a number of different categories marked by their professional credentials, commercial focus, and mode of selling. The two principal groups are independent and commercial sellers, although there is significant variation within each.”).

<sup>648</sup> FTC (2004), 12 (“[n]on-traditional contact lens sellers, such as Internet and mail order providers, represent a unique alternative distribution channel and offer some consumers a combination of price and convenience that they value highly.”). FTC (2004), 13 (“consumers can often achieve significant savings by purchasing replacement lenses from sellers other than their eye care providers...”).



accomplishing the goals of contact lens manufacturers. Many alternatives for inducing retail promotion have been identified over time in the literature and each should be examined. These alternatives should also be examined for their relative efficiency and effectiveness when compared to manufacturers' pricing practices. Available information suggests that some manufacturers pricing practices involve detailed specifications and extensive monitoring and therefore may not be as efficient or effective as may be claimed by theory. Future analyses should particularly investigate the reasonability of compensating ECPs for their promotional efforts through fees paid by consumers and payments by manufacturers. Each was examined previously by the FTC and found to potentially be reasonable alternatives to restrictive practices found at the time. Restrictive distribution arrangements should also be examined given potential efficiencies and increased competition has been previously associated with their use. Finally, shopper centric strategies which represent a paradigm shift in their approach to consumer free riding behavior should also be examined. Various aspects of the distribution for contact lenses appear to be consistent with the use of such strategies.

## CONCLUSION

RPM is a controversial pricing practice for managing channels of retail distribution. The Supreme Court's decision in *Leegin* abolished a nearly century-old *per se* rule against RPM and replaced it with the rule of reason – a less restrictive, yet more complex standard for assessing the reasonableness of competitive conduct. Following the decision, a number of manufacturers of consumer products have adopted RPM and related practices in the management of their retailer relationships. The use of restrictive pricing practices in the contact lens industry have recently drawn attention and elevated debate over the practice. Viewed as an important “test case” for antitrust's new vertical pricing regime following *Leegin*, this paper examined important dimensions of the contact lens debate and related lawsuits that share significance for scholarship and practice. This effort yielded insights that inform understanding of the antitrust implications of contact lens manufactures' pricing practices and that advance academic knowledge, marketing practice and competition policy involving RPM.



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**Table 1. Supreme Court’s Decision in Leegin**

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*Leegin* involved allegations of minimum price fixing against Leegin Creative Leather Products by the owner of Kay’s Closet, a women’s apparel store operated by PSKS, Inc. Leegin was both a manufacturer and retailer of women’s accessories sold under the Brighton brand and distributed through small independent retail boutiques and Leegin-owned “Brighton Collectibles” specialty stores. Leegin stopped selling to PSKS following revelations that Kay’s Closet had been discounting Brighton products in violation of Leegin’s pricing policy. PSKS sued Leegin for a per se violation of the antitrust laws based upon its conduct of entering into agreements with retailers to fix the price at which Leegin’s products could not be sold below (i.e. minimum RPM). A Federal lower court agreed with PSKS and awarded it nearly \$4 million. The award was upheld by the Court of Appeals. The Supreme Court granted certiorari (i.e., judicial review) to determine whether vertical minimum RPM agreements should continue to be treated as per se unlawful. Relying largely, if not exclusively on economic theory, the Court overruled its decision in *Dr. Miles Medicine Co. v. John D. Park & Sons* (1911) to hold that henceforth “vertical price restraints are to be judged by the rule of reason.”<sup>649</sup>

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<sup>649</sup> Leegin (2007), 877.

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**Table 2. Key Federal Legislation and Supreme Court Cases**

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<b>Public Policy Decisions</b>	<b>Description</b>
<b>Federal Legislation</b>	
Miller-Tydings Act (1937)	Permitted states to pass so-called “fair trade” laws legalizing RPM within their states.
McGuire Act (1952)	Permitted states to pass fair trade laws allowing manufacturers to enforce RPM on all retailers if at least one retailer signed an RPM agreement.
Consumer Goods Pricing Act of 1975	Repealed the Miller-Tydings Act (1937) and McGuire Act (1952).
<b>Supreme Court Cases</b>	
Dr. Miles Medical Co. v. John D. Park & Sons (1911)	Affirmed a lower court's holding that a minimum resale price maintenance scheme was unreasonable and thus offended Section 1 of the Sherman Antitrust Act.
United States v. Colgate & Co. (1919)	Found in relation to any inference of an illegal price fixing agreement and the Sherman Act “[i]n the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal; and, of course, he may announce in advance the circumstances under which he will refuse to sell” (p. 307).
United States v. General Electric (1926)	Ruled that the <i>per se</i> rule against RPM does not apply to agency relationships or where a good is sold on consignment.
Monsanto Co. v. Spray-Rite Serv. Corp (1984)	Articulated the standard under which a price fixing agreement may be inferred finding that “[t]he correct standard is that there must be evidence that tends to exclude the possibility of independent action by the manufacturer and distributor. That is, there must be direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others had a conscious commitment to a common scheme designed to achieve an unlawful objective” (p. 768).
Business Electronics Corp. v. Sharp Electronics Corp. (1988)	Held that “[t]here has been no showing here that an agreement between a manufacturer and a dealer to terminate a ‘price cutter,’ without a further agreement on the price or price levels to be charged by the remaining dealers, almost always tends to restrict competition and reduce output” (p. 727-28).

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